Economic Affairs / A Monthly Analysis

A special supplement to CHALLENGE

November 1, 1961

WILL CONSUMERS BUY? Businessmen, government officials and economists are asking this question as the purchasing season gets under way. Traditionally, autumn has always been a period of high retail activity, and this is the first autumn since the recent recession in which consumers have had a chance to show their desire to spend.

On the whole, they've got the money. Personal income has been going up steadily since February. This increase has come about as production returned to prerecession levels and as employment kept going up. Personal income is now at a record peak.

Where are the customers? During the recession, people cut back on consumption and tried to reduce their debts. With the rise in income, consumption turned up again, but at a slower rate. As a result, savings went up. The increased income was like money in the bank, and that's exactly where people put it.

When their savings are high and their installment debts low, consumers are said to be in a relatively liquid position. In the past, this has usually been the signal for an upsurge in consumer spending. Up to now, however, retail sales have been disappointingly low, particularly in the area of consumer durable goods.

The question is an important one, because a revival in this sector of the economy can make the difference between what is merely a recovery, and a vigorous boom. A healthy prosperity is sparked by business outlays for plant and equipment. This, in turn, comes when consumer demand for goods exceeds the nation's capacity for producing them. Right now, we are producing at a little below 80% of capacity.

Surveys reveal that consumers are still somewhat hesitant about committing their income to the purchase of "big ticket" items, although less hesitant than they were a few months ago. This hesitancy is hardly surprising in the light of the high rate of unemployment which has persisted through the recovery and the disturbed state of world peace.

In addition, a long-term shift in consumer spending habits continues to evolve. Whereas services absorbed less than 30% of the consumer's income 10 years ago, the figure is now about 40%. Two things are happening. One is the consumer's desire for more services; the other is the sharply rising price of services. These two factors combine to divert consumer income away from the durable goods sector of the economy.

By the end of the year, the pattern of consumer expenditures will have been established. It will certainly be higher than last year. Since there is still a good deal of slack in the economy, a brisk level of retail activity can be supported without putting very much pressure on the general level of prices, and can help to bring the rate of unemployment down a little from the onerous figure of 6.9%. A real spending spree, however, would bring back the specter of inflation.

SPECIAL CORRESPONDENCE—The anticipated rise in interest rates has failed to materialize. The reason is twofold: consumers have failed to increase their installment purchases at the same pace as in previous recoveries, and businesses, which floated so many bonds during the first half of the year, have not found it necessary to step up their bank loans.

Because of the reluctance of consumers and businessmen to step up their borrowing, the Treasury has been able to borrow money for deficit spending without pushing up interest rates. The picture, however, is bound to change by the end of the year as business seeks additional funds to build up inventories and consumers begin to step up their purchases of 1962 automobiles.

If these pressures build up too rapidly, the ever-wary Federal Reserve Board is almost certain to tighten up credit to blunt the inflationary impact.

The Administration, however, is faced with a far more difficult choice. Besides the problem of inflation, it must also consider our economic growth rate and the balance of payments. It wants to keep interest rates low to encourage new investment; but low interest rates will start a flight of funds to countries—notably Britain—where higher rates prevail. This could only serve to stimulate a further drain on our gold reserves.

In the end, the President will probably conclude that the international position of the dollar comes first.

Labor has already begun a massive lobbying campaign to defeat two bills which Sen. John McClellan (D.-Ark.) introduced at the end of the last session. One, which is directly aimed at James Hoffa's Teamsters Union, would prohibit strikes in transportation industries. The other bill would prohibit strikes at key defense installations.

In the case of the bill aimed at the Teamsters, McClellan introduced it as a measure to amend the antitrust laws rather than as new labor legislation in order to get around the generally prounion Labor and Public Welfare Committee, headed by Sen. Lister Hill (D.-Ala.). Antitrust legislation must go through the more conservative Judiciary Committee, headed by Sen. James Eastland (D.-Miss.).

Although the Administration has not officially stated its position on either measure, most observers feel that the President is less than enthusiastic about both of them. While Senate conservatives are enthusiastic, most of the middle-of-the-roaders would rather not incur labor's wrath in an election year.

The problem of overcapacity, which has plagued the United States in recent years, is a growing concern in Western Europe. Automobiles, oil and chemicals are the industries most often cited. A good deal of the overcapacity can be attributed to the heavy American investment of the past few years, which was stimulated by tax advantages and the recession in the U.S.

These are the very tax advantages which the Administration wanted to repeal in the tax reform bill which Congress failed to act on. The President is keenly interested in redirecting U.S. private overseas investment from Western Europe to the underdeveloped areas.

South Africa is cultivating the Japanese in a drive to find new trade sources to replace the losses it suffered when it left the British Commonwealth. The first result is the establishment of a Japaneses electronics firm at Port Elizabeth.

COVER BY HOWARD WINTERS

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THE NEW LOOK

IT IS A CURIOUS THING that a couple of simple, matter-of-fact newspaper stories can shake an ordinary person's notion of what is right and what is wrong, what is white and what is black. Take for example the news that came out of Moscow and Paris two weeks ago—far more significant news, although these particular stories got no headlines, than Khrushchev's announcement of a 50-megaton nuclear weapon or de Gaulle's reluctance to accept the position of his allies on the Berlin situation. I refer to the almost simultaneous unveilings, in Moscow and Paris, of plans for the economic future of the two nations—one on the wrong side of the Iron Curtain, the other on the right side, at least geographically.

That last phrase, "at least geographically," should not be taken as a swipe at our French friends. It is a reflection of the confusion that could arise in a person's mind when he learns that the French government has drawn up a four-year economic plan—*the fourth since 1948!* The woman in Akron, Ohio who exclaimed, "Well, I'll be . . . I thought only the commies had a planned economy"—that woman is not alone.

And that is not all. Implicit in the French plan is a de-emphasis of the consumer-oriented economy, the kind of economy that provides the most salubrious atmosphere for the free-enterprise type of economic organization. The "society of consumption" is condemned as one that gives "futile satisfactions." The economic plan for the period from 1962 through 1965 does call for a 23 per cent increase in private consumption, but the emphasis is on investment, heavily concentrated in the public sector of the economy. The increase in investment is put at 28 per cent for industry and agriculture, 25 per cent for housing, and more than 50 per cent for such "collective interests" as education, sports facilities, hospitals and urban planning.

When you consider that the French government already controls the largest banks and insurance companies, the coal mines, railroads, electricity and gas production and telecommunications, you get a fair idea of how large government and government planning loom in the workings of the French economy.

From the other side of the Iron Curtain we get another picture of government planning. As long ago as last May, Khrushchev was quoted as saying: "Now we consider our heavy industry as built. So we are not going to give it priority. Light industry and heavy industry will develop at the same pace." On October 18 he modified his earlier statement. Before the twenty-second congress of the Communist Party he said that during the next two decades the production of consumer goods would increase at a rate "considerably approaching" the rate of growth of capital goods.

More precisely, the twenty-year outlook is that increases in heavy industrial production will be "approximately twenty per cent higher" than the production of consumer goods. This is not exactly development "at the same pace," but a considerable reshuffling in the allocation of the Soviet Union's resources is indicated. Khrushchev expects a five-fold increase in consumer goods production by 1980.

In the words of the King of Siam, "it is a puzzlement." On the one hand we have a major ally apparently going deeper and deeper into the process of planning—albeit in the context of a free economy, still—with all that this could imply for those who always thought a major difference between East and West was a planned economy vs. a "free" economy. On the other hand we have this same ally, who is as Western-oriented in the values of our civilization as any nation could be, announcing, as a matter of policy, a de-emphasis of the private consumption sector and the beefing up of the public sector; while almost at the same moment the task masters of the Kremlin are talking about narrowing the gap between the production of their producer and consumption goods.

. . . from two worlds

Let no one conclude from all this that the French, and presumably other important members of the Western world, are rushing headlong into communism, while at the same time the Soviets are moving more and more towards the consumer-orientation that characterizes free enterprise economic efforts, as most beautifully illustrated in the United States. There is more to denigrating a silk purse to a sow's ear than this, or vice versa. But clear thinking on the issue of just what are the differences between East and West is jostled by such developments as outlined above.

Anyone who thinks about this for a moment or two is going to arrive at the shocking realization that free enterprise, as it is practiced in those parts of the world *with* whom we shall have to stand or fall, is considerably different from our traditional assumptions of what free enterprise is supposed to be. And even in our own country the evolutionary process has begun to restrain the "invisible hand" that according to Adam Smith would direct the constructive free flow of individual enterprise energies.

In short, the presence or absence of economic planning is no longer a matter of black and white choice between contending systems. Nor will consumer orientation or non-consumer orientation be a safe guide, within a generation, to the vital differences between two ways of life. We shall have to dig deeper than economic performance to find the inspiration for our salvation. More on this at another time.—H. B.

LETTERS TO THE EDITOR

CHALLENGE invites your comments. Address letters to CHALLENGE, 475 Fifth Avenue, New York 17, N. Y.

ECONOMIC FORECASTING

• In the October issue of your magazine you published a thoughtful and closely reasoned article by William C. Freund, entitled "Are the Forecasters Too Optimistic?"

In his article, Prof. Freund is in basic agreement with us concerning two of the assumptions on which our projections are based—the size of the employed labor force in 1970 and the average length of the workweek at that time—though he enters a cautionary note that unemployment may not prove to be as low as 3.5 per cent of our labor force. For the sake of accuracy we wish to point out that at the bottom of our chart "GNP Projections, 1960-70" on page 38 of your June issue we define "reasonably full employment" as an unemployment rate of not more than four per cent of the labor force, and we have based our estimates on this assumption.

Thus, while Prof. Freund's cautionary note is certainly in order, our differences on this point are minor. This means, as indeed he recognizes, that his major objections to our projection of an $800 billion economy must rest squarely on a fundamental disagreement with our estimates of a 3.3 per cent annual rate of productivity gain in the private sector of the economy during the coming decade.

Prof. Freund does not question that our economy *could* achieve our projected increase in production during the Sixties. He has two main reasons for his assumption that a 2.5 per cent rate of productivity gain during the coming decade would be more realistic, even though he admits that since 1947 such gains have averaged 3.2 per cent annually. He cites the fact that consumer demand was stimulated by war and postwar shortages during the last 15 years, and, at the same time, a relative scarcity of young workers entering the labor market induced heavy investment in machinery and all kinds of labor-saving devices.

According to Prof. Freund both these were exceptional and cannot be expected to provide the same stimulus for productivity gains in the future. Therefore, he warns against "overly mechanical extrapolations of the three fundamental factors of economic growth—productivity, employment and hours worked."

We must emphasize that our projections have never been based on any such "overly mechanical extrapolations." We are quite prepared to agree that a "do-nothing" or "drift" policy will result in a lower rate of productivity gain than we have forecast.

However, we cannot agree that the Sixties will be characterized by a "do-nothing" policy. On the contrary, we are confident that the government will take reasonable steps in support of economic growth and that such steps will allow full scope for the many factors making for greater productivity gains to assert themselves.

We have in mind particularly the fact that we are on the threshold of the widespread adoption of automation and other technological advances in all sectors of our economy—in the office and retail store, as well as in the factory and on the construction site. Substantial gains in the average educational level of our work force during the coming decade will provide added opportunities for the realization of productivity gains.

These facts make us confident that our expectations are reasonable and not overly optimistic. Indeed, we believe that the domestic threat of large-scale unemployment and the international threat in a period of "competitive coexistence" will compel us to recognize that our rate-of-growth forecast of about 4.5 per cent annually (or 4.3 per cent once the present slack in the economy has been overcome) represents a minimum goal which we must achieve in order to discharge our responsibilities effectively. We believe that an $800 billion economy by 1970 is a realistic expectation.

GERHARD COLM
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National Planning Assn.
Washington, D.C.

INVESTOR'S COMPLAINT

• Just what was Burton Crane trying to get at in his article, "What Goes Up Can Come Down" [October, 1961]? In his concluding paragraphs he carefully points out that he is not advising Wall Street investors either to buy or to sell and that "surprises can send stocks in either direction."

I was hoping when I began the article to find out something I didn't know.

WALTER HODGES
Boston, Mass.

ACHIEVING THE GOOD LIFE

• Harvey E. Brazer in "A Nationwide Treasure Hunt" [October, 1961] points out that the obstacles which prevent us from doing away with "public squalor" are largely political rather than economic. In other words, the money *is* available, if only we could get past the political impasse of *how* to get at it—whether through sales taxes, income taxes or what have you. But since almost any of the means under discussion will achieve basically the same end—a better life for *all* citizens—there isn't much point in quibbling.

Or is there? Maybe the politicians are not arguing out of shortsightedness or out of a misguided devotion to "principle" but out of a spirit of asceticism. As Mary McCarthy, the distinguished author and critic, has pointed out: "No nation with any sense of material well-being would endure the food we eat, the cramped apartments we live in, the noise, the traffic, the crowded subways and buses. American life, in large cities, at any rate, is a perpetual assault on the senses and the nerves; it is out of asceticism, out of unworldliness, precisely, that we bear it."

It's an interesting idea—to think of our public squalor as the hair shirt of an unworldly society. At any rate, I find Miss McCarthy's Alice-in-Wonderland view of the problem much more exhilarating than the depressing facts of the case as outlined so ably by Mr. Brazer.

BELLE PEASE
New York, N. Y.

TWO BOUQUETS

• It is my intention to again use CHALLENGE in my classes. Last year I used the magazine extensively and found the results very good.

RAY O. WERNER
Associate Professor of Economics
Colorado College
Colorado Springs, Colo.

• I enjoy your magazine very much and it has proved useful in the classroom in making the theoretical material come into reality.

JAMES H. WILSON
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MEASURING THE COST OF QUALITY

by RICHARD RUGGLES

► *Is the Consumer Price Index an accurate barometer of changes in the cost of living? Although the* cost *of medical care, for example, has risen 30 per cent over the past eight years, there have been offsetting medical advances of immeasurable value.* PROF. RICHARD RUGGLES *of Yale believes that because of its failure to reflect quality improvements, the index has a built-in upward bias which creates an erroneous impression of actual living costs.*

THE BOGY of inflation is with us again. This cry, which was chronic during the Fifties, has been a major factor in determining our monetary and fiscal policies. Since these policies are based on the movements in the price indexes, it is time to consider whether our confidence in these indexes is justified.

Since 1948 the Consumer Price Index has increased by approximately 25 per cent. A large part of this increase—about one-third of it—occurred in the brief space of one year, at the beginning of the Korean war. The other two-thrids was spread more or less evenly over the other 12 years—an average increase of about one and a half per cent a year.

In view of these statistics, policy makers might have concluded that we had relative price stability in the Fifties, except at the beginning of the Korean war when scare buying forced prices up. Instead, we hear much about a continual and insidious price creep. When price indexes continued to rise during periods of recession, such as in 1958, many policy makers concluded that rising prices stemmed from increasing costs due to excessive wage demands and administered prices of monopolies.

To understand what has *really* been happening to prices, we must first examine the factors responsible for the rises in the index. For this purpose let us take a look at the 12 per cent increase in the Consumer Price Index that has occurred since the Korean war. There are major segments of consumer purchases for which prices have not risen at all since that time. The price index for consumer durables, for example, shows a decline of approximately three per cent. On the other hand, the index for medical care rose by more than 30 per cent. On the average, the prices of services rose a substantial 23 per cent, while those of commodities rose only six per cent.

This difference in behavior largely reflects the fact that the price of a service is generally the rate of compensation of those performing it. And these wages naturally rise as per capita income rises. In the last 50 years the prices of services relative to those of commodities have risen continually as a consequence of such general rises in living standards. Commodity prices, on the other hand, can sometimes reflect increased productivity. If the increase in output per man-hour is greater than the increase in the wage rate, the cost of production may actually fall, thus permitting lower commodity prices despite higher wages.

The identification of price indexes with rates of pay in the service industries involves the implicit assumption that the productivity of the service industries has remained unchanged. In some instances, this assumption may be correct, but in others quite wide of the mark.

In the case of medical care, for example, the apparent 30 per cent price increase of the last eight years must be qualified by considering the increase in medical knowledge, better drugs and the new preventive medicines. Certainly the Salk vaccine was a tremendous medical advance which, in addition to sparing many lives, will save consumer dollars that would have gone for the treatment of polio.

Basically, then, the measurement of price changes comes down to a question of whether one gets more or less for his money. In the field of medical care it can be argued that most people would rather pay today's prices for today's medical care than yesterday's prices for yesterday's medical care. The fact that diseases were treated more cheaply in yesterday's world is more than offset by the increased knowledge and new drugs available for curing disease today. Although it is difficult to measure improvement in the *quality* of medicine in quantitative terms, there is no justification for ignoring it—which is what our present method of computing price indexes does.

THE PROBLEM of measuring changes in quality also arises in the commodity components of the Consumer Price Index. In the Congressional hearings on government price statistics conducted early this year, Prof. Zvi Griliches of the University of Chicago reported on the effect that changes in specifications had upon automobile prices. Dr. Griliches computed the value of specifications such as size, automatic transmission, horsepower, etc., by taking the price differences for a given year among cars with these varying specifications. Automobile prices were then adjusted to take into account the different features included as standard equipment in each year.

On this basis, using the value of specifications given by the 1954 price schedule, the prices of the "low-priced three" dropped 27 per cent from 1954 to 1960, although their unadjusted list price rose 34 per cent, and the Consumer Price Index for these automobiles reported a rise

of 11 per cent. The significance of this study is not that the Consumer Price Index for automobiles needs some minor adjustment to reflect the true price situation, but rather that the overemphasis on price change is itself in question. Instead of an 11 per cent price increase over this period, there may have been a price reduction of as much as 27 per cent.

This same kind of analysis could, of course, be applied to other major kinds of consumer durables, such as home laundry equipment, refrigerators and freezers, portable radios, cameras and hi-fi equipment. Almost all of these have shown considerable change in recent years. If the change in *quality* were taken into account the price index for consumer durables would have fallen far more than the three per cent now reported.

BESIDES THE quality change in existing goods, we should also take into account the effect of the introduction of totally new commodities upon the consumer's purchasing power. The index of consumer prices is purposely designed so that the introduction of new goods or the dropping of old ones will have no effect. Thus the introduction of such things as television, synthetic fibers and plastic products has had no effect upon the index.

But the introduction of new products obviously *does* have an influence upon consumers' standards of living, just as do quality improvements in existing products. It is quite possible to imagine an economic system which obtains its higher standard of living through the introduction of new products which are superior to the old ones they replace. In such a system, the consumer might continuously get more value for his dollar, even though the prices of the old products rose steadily due to rising wage and material costs. Yet conventional price indexes would show this situation as one in which prices are rising and consumers are getting less for their dollars. Although, of course, in our economy not all of the improvement in the standard of living comes about through the substitution of new products for old, it does seem clear that much of it has been achieved in this way, despite the systematic exclusion of this factor from price indexes.

Innovations and new products are not restricted to the durable goods field. They have, for instance, been highly significant in the food industry over the last decade. Meals are much easier to get and the choice available to the housewife is much greater. There will be those who claim that the additional packaging and processing now common is an undesirable element of cost, and that the personal contact between the individual proprietor and the customer has been lost. Conversely, it can be argued that increased attention to packaging not only standardizes the merchandise, but it raises the level of sanitation and grading. In addition, the freedom to examine goods allows the customer to make comparisons before buying in a way that would not have been possible before.

It is, of course, not possible to measure accurately the dimensions of quality and product change. Nevertheless, one can safely suggest that, given the size of the average yearly increase in the Consumer Price Index since Korea, quality and product improvements may well have been much greater, so that we may actually have had declining rather than rising prices.

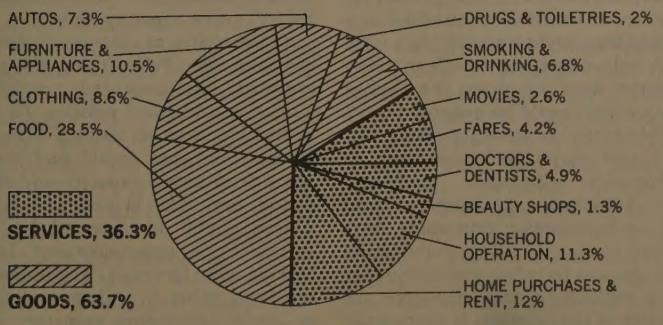
This does not mean that price indexes are completely invalid. Price indexes are useful in that they can show the relative differences in price behavior over time or between countries. For example, the eight per cent increase in the price index at the beginning of the Korean war indicates that prices were rising more rapidly in this period than at any other time in the decade of the Fifties.

In periods of hyperinflation, such as have been experienced by some Latin American countries in recent years, where the price index may rise by as much as 80 per cent in a single year, the indexes give a good indication of what is happening since such large increases cannot be offset by quality change. It is only in periods when price changes are relatively small that it becomes a serious error to use the indexes as an exact measure of what is taking place in the economy. In such periods the systematic biases of the price index may well be greater than the reported price change.

THE DEFECTS of the Consumer Price Index are also inherent in the other price indexes which are used to deflate the gross national product to measure the change in real output. Two major categories of goods are produced by the economy besides consumer goods. These are goods and services purchased by the government, ranging from school teaching to missiles, and plant and equipment purchased by producers for use in later production. To measure the quantity of output in these categories, we need price indexes to calculate it in noninflationary terms.

In measuring the output of government, it is assumed—as it is throughout the service sector—that the productivity of civil servants never changes. The price indexes for this area are merely based on the changes in pay of government employees. While one may be tempted

MAKE-UP OF THE CONSUMER'S MARKET BASKET*



*Relative weights of goods and services used by Bureau of Labor Statistics to prepare the Consumer Price Index.

to agree with this evaluation of civil servants, the fact is that the introduction of computers, office machines and other automatic equipment has greatly increased the effectiveness of the individual worker. For example, the 1960 census data were processed by microfilming the original schedules and automatically producing magnetic tape for the electronic computers. Automatic equipment performed jobs which took thousands of clerks in previous censuses. Not only was the payroll reduced, but far more information was made available in a much shorter space of time. Output per census employee thus rose very considerably.

SIMILAR examples of the increased output of government employees can be cited at the local level. For example, policemen have been provided with radio-equipped patrol cars and, more recently, transistorized walkie-talkies. Street cleaners have been given mechanized equipment. In some areas—education, for instance—progress is more difficult to measure. Yet most of us would be unwilling to have our children given the same education as we received, especially in the areas of sciences and mathematics.

In producers' durable equipment, once again, the price indexes leave out quality change and new products. But there are probably very few industries in which producers in 1960 would have been willing to buy 1950 models of machines even if they could get them at the 1950 prices. According to the Wholesale Price Index the 1960 price of producers' durable equipment was 23 per cent above the 1950 price; if producers' durable equipment showed as much quality change as was shown in the study referred to above for automobiles, it seems probable that in fact prices actually fell.

For construction, both industrial and residential, the index is computed on the basis of wage rates and material costs. Thus again it is assumed that productivity does not change. While the construction industry is notorious for its lack of progressiveness, if we consider the new methods of off-the-site fabrication of components it is obvious that this assumption is not entirely valid. Once again, it seems that price indexes have greatly exaggerated the actual price rise.

Thus, we see that for almost every category of goods, whether purchased by consumers for household consumption, by government for public services or by producers for plant and equipment, the conventional price indexes do not reflect the effects of the introduction of new products and the improvement of existing products, or the increased productivity of those performing services. These omissions mean that the price indexes are higher than they should be. And since the indexes are used to deflate the value of current output and calculate its worth in noninflationary terms, our

rate of growth is thus considerably understated.

The fact that our growth rate has probably been higher than we thought does not mean, however, that we should be any happier vis-à-vis the Russians. These elements would also have at least as much effect upon the Russian figures. As we well know, the Soviet rate of technological progress in some areas has exceeded ours, but even in the areas where they are still well behind us, the *rate* at which they introduce new technology might be faster than ours.

A half-century ago many more industries were producing the kind of output that could be measured quite satisfactorily in quantity terms. Today new major industries such as electronics, chemicals, machinery and household appliances account for an increasingly important share of our output. In all these industries the changes in prices and output are very difficult to measure, since the nature of the products is continually changing. It may mean, therefore, that the national concern over a sagging economic growth rate is really not warranted. The problem may be our inability to measure growth represented by product changes and increased productivity in the service industries. The inadequacy of the price indexes will become even more glaring in the years ahead.

It is interesting to speculate on what will happen to our measurement of output when further growth does not take the form of additional consumption of identical items, but rather of the consumption of goods of improved quality, the substitution of new products for old and the consumption of higher quality services. In such a world, our conventional price indexes would fail to catch the quality improvement; they would not recognize that the substitution of new products for old was any increase in the standard of living; and they would report the continued increase in the use of services solely in terms of the rates of remuneration. Thus they might show an economy with constant output and rising prices, even though the standard of living was increasing rapidly. What is perhaps more serious, the conventional price and output indexes would fail completely to distinguish between a dynamic economy and one that was truly stagnant.

THE single-minded pursuit of price stability, coupled with the false soundings given by our present price indicators, is likely to lead our economy policy makers astray. The tragedy of the postwar period is not so much the low rate of growth (which we cannot measure anyway), but rather the underutilization of our resources and the low level of investment to which the continuous existence of excess capacity leads.

At the quiver of a decimal point in the Consumer Price Index, the government has instituted restrictive monetary and fiscal policies. Its objective has been to restrain demand so that producers would find themselves with excess capacity and thus would not raise prices; and labor unions would be deterred by the existence of unemployment from seeking wage increases. The economy has been either in a depressed state or under restraining monetary and fiscal policies throughout almost the

entire period since Korea. It is small wonder that in such an environment the rate of investment is low. In an economy where a false fear of inflation continually holds demand in check, even a low level of investment creates capacity which cannot be fully utilized.

With this in mind, it is appropriate to inquire what a faster rate of growth and better utilization of our capacity would do to our price indexes. Historically, if we look at any period of upward change in the general level of activity, we find that the price indexes rise. Thus, for example, in the recovery from the depression of the 1930s, prices in certain sectors responded sharply to the increase in demand. Farm prices rose by about 85 per cent in the five years from 1932 to 1937. Even in the metals industry, prices went up about 30 per cent. At the same time, unemployment dropped from 25 per cent to about 14 per cent. It cannot very well be argued that these price rises were the result of excess demand pressing on fully employed resources.

In other words, growth and the increase in real income tend to produce price increases in certain sectors irrespective of the pressure on resources. If the price index is to remain stable, the increases in such sectors would have to be balanced by lower prices in other sectors, where productivity increases would permit prices to fall. Given the imperfections of our price indexes, however, economic growth will almost inevitably result in an upward movement of the price index irrespective of the pressure of demand.

DESPITE the relatively high unemployment rate of close to seven per cent, there is a tendency to minimize the underutilization of our resources which has resulted from too much concern with small movements in the price index. It is argued that at least four per cent of this is frictional unemployment, and thus that we are operating at 97 per cent of full employment—a high level in anybody's vocabulary. Such a computation, however, is very misleading. The unemployment rate is not very closely related to the economy's excess capacity. The spread of automation and the increase in the number of white-collar employees means that many industries can expand their output considerably without hiring many more workers. Thus, a steel company operating at 50 per cent capacity might be able to double its output by adding 10 or 20 per cent more employees. This is even more true in such sectors of the economy as electric power, communications, finance, insurance and retail trade—all sectors whose activity (and thus output) increases with an increase in the general level of activity of the economy without requiring any substantial increase in manpower.

This relationship between the increase in man-hours employed and the increase in output shows up clearly in the over-all statistics. In the recoveries from all of our past recessions output has risen much faster than man-hours employed. On average, output tends to rise during economic recoveries about three times as fast as the man-hours required to produce it. In the first six months of the present recovery, if we are to believe the figures, an increase in output of approximately five per cent has been accompanied by an increase in man-hours of less than one per cent.

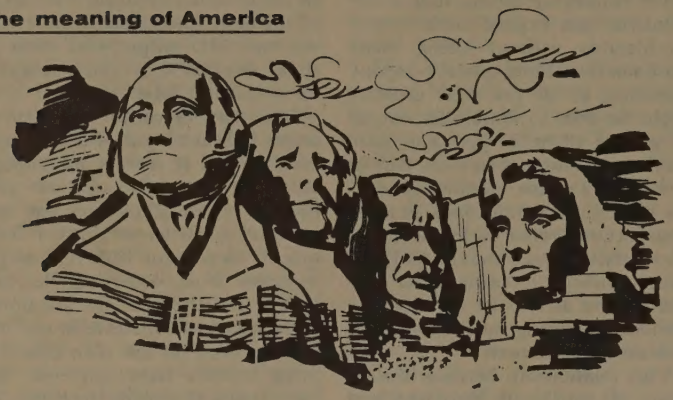
Much of the increase in manpower that is needed, furthermore, does not come from the reservoir of the unemployed. Unutilized manpower within firms is drawn upon, and cuts in the workweek which may have been put into effect during the recession are restored. With increasing employment opportunities, the labor force itself tends to expand, thus providing additional resources. Even allowing for frictional unemployment, it seems reasonable that there could be an increase of 10 or 12 per cent in man-hours.

THE Council of Economic Advisers has estimated that in early 1961 the economy was operating at a level some 10 per cent below full capacity. This figure seems far too conservative when one takes into account the additional man-hours available and their relation to potential output. If past performance is a guide, it would not seem unreasonable to suppose that the 10 or 12 per cent additional man-hours which were available in the spring of 1961 could have been utilized to produce 25 per cent more output. This seems all the more likely since, by late summer of 1961, output had risen by about five per cent and unemployment had not fallen at all.

It is true, of course, than an increase in real output of 25 per cent, even though it created no pressure on resources, would cause our price indexes to rise. Under present anti-inflation policy we would then move quickly to prevent such real output increases from occurring. In fact, that is exactly what we are doing, even though the increase in real output has been far less than this. The price indexes have quivered, and there is talk of putting the brakes on. Those wishing to restrict demand have labeled the unemployment "structural," and thereby have succeeded in removing it from their own consciences. This rationalization may satisfy them, but it is not much help for the unemployed—since it is obvious that the only cure for unemployment, whether structural or any other kind, is more jobs, and you don't get more jobs by restricting demand, no matter how much retraining you do.

THE LOSS in potential output may not seem to be very impressive when expressed in percentage of total output, but, in fact, we waste through underutilization an amount equal in size to two or three times what we now spend on defense, or 20 to 25 times as much as we now are giving in foreign aid. These wasted resources could rebuild our cities and automate our factories within a few short years; they could raise our rate of growth to equal or surpass that of any other nation.

This then is the cost of taking our price indexes too seriously. We inhibit real growth, because growth by its very nature must lead to increases in the price indexes. And because this inhibited growth in output does not keep up with the growth in our capacity to produce, we have ever-present excess capacity. The excess in machines is self-limiting; producers soon learn when investment is unprofitable. But the excess in manpower is harder to dispose of—the unemployed are there, and you can't really make the problem go away by saying that they don't exist. ■



NATIONAL GOALS FROM LEFT TO RIGHT

by ROBERT LEKACHMAN

► *A combination of the Soviet threat and a high level of affluence has made Americans more aware of the necessity for defining the goals of our society.* PROF. ROBERT LEKACHMAN *of Columbia examines the range of views on this question, from Goldwater to Galbraith. Although we cannot return to the 19th-century world of low taxes, small business and limited government, the choice of what direction must be taken is still in our hands.*

IN 1776 the signers of the Declaration of Independence identified a national purpose without difficulty: it was the pursuit of life, liberty and happiness, free of the officious interference of Great Britain.

The vigorous discussion of national aims of the last few years implies a groping for a new statement of objectives in all areas of American life. The evidences of this endeavor are numerous. In a remarkable series of reports sponsored by the Rockefeller Brothers Fund, panels of eminent Americans examined our foreign policy, our educational system, our military posture and the condition of our economy. Its report on the last topic, entitled *The Challenge to America: Its Economic and Social Aspects,* carefully estimated the probable demands on our resources for urban development, agricultural programs, education, defense, foreign aid and social welfare. Its most widely circulated conclusion identified a four per cent rate of growth every year as indispensable to the fulfillment of our needs, and a five per cent rate as highly desirable.

Life and *The New York Times* sponsored a series of discussions of national purpose which covered some of the same ground as the Rockefeller Reports. Taking public note of these discussions, former President Eisenhower, late in his second Administration, established a Commission on National Goals headed by Henry Wriston, formerly President of Brown University and more recently a respected and much sought after adviser on domestic, economic, political and social affairs. Its report, which was signed by a group of distinguished leaders* from diverse fields, emphasized the continuing primacy of such traditional American goals as individual liberty, freedom of economic choice and diffusion of economic power.

These three highly organized and impeccably sponsored efforts to clarify our national goals are examples of a much wider discussion of the meaning of America. The new flowering of conservatism on the college campuses, encouraged by William Buckley's periodical the *National Review,* the success of Sen. Goldwater as an advocate of diminished public action and increased individual responsibility, and the emergence of such a new conservative periodical as the *New Individualist,* testify to an intense preoccupation with the meaning of the American past and the shape of the American future. Even the weird John Birch Society seeks the essential America, though it is possible to question whether essay contests to select the best case for the impeachment of Chief Justice Warren are the most fruitful mode of advancing the American dream.

Liberals as well as conservatives have engaged themselves in the discussion. Arthur Schlesinger, Jr. argued that the new American frontier of aspiration is to be found in an improvement in the quality of human experience rather than in an extension of our command over consumer goods and mass entertainment. In his controversial *The Affluent Society,* John Kenneth Galbraith has challenged his fellow citizens to reconsider the manner in which we divide our energies between the public and the private sectors.

WHAT HAS caused this flurry of lively argument and often heated debate? One obvious stimulus has been the challenge of Russian communism. In its economic aspect, that challenge has frequently focused on comparative growth rates. Although growth statistics are even trickier than statistics in general, such experts as Allen Dulles agree that Russia has been expanding its economy at a faster rate than the United States in the postwar period. Premier Khrushchev is premature in his boast that the Russians will match our standard of life by 1970. Nevertheless, the slack in our economy, our uncomfortably high rates of unemployment and the spectacular Russian successes in rocketry have combined to stimulate an anxious examination of our economic performance.

* *James Conant, former President of Harvard; Crawford Greenewalt, President of Dupont; Gen. Alfred M. Gruenther; James R. Killian, Chairman, Corporation of MIT; Clark Kerr, President, University of California; George Meany, President, AFL-CIO.*

A divine discontent is much more likely to arise in the hearts of the well-fed than in those of the hungry. Here is a second stimulus to the national debate. The United States, in spite of its failure to operate at full speed in the last generation, has performed material marvels. The good things of life, not alone the consumer durables which are often taken to be the symbol of the American standard of life, but medical care, education, books, music and recreation have been distributed in ever-larger quantities to ever-increasing proportions of the population. While Negroes and other minorities have not fully shared in these fruits of American productivity, even *their* incomes have tended to increase quite rapidly.

A Khrushchev can hold out to his people the prospect of television sets, automobiles, refrigerators and decent homes as satisfactory goals, secure in the knowledge that a people which has been materially deprived for so long will hunger for these comforts and modest luxuries almost to the exclusion of other objectives. But, as the somewhat depressed state of the auto and electrical appliance industries implies, Americans may have gratified their most pressing desires for these amenities of life. Thus it is quite understandable that the question of what lies beyond material affluence has evoked such a national soul searching.

THIS SOUL SEARCHING is also entwined with a traditional American suspicion of size and economic power. A great many Americans of quite diverse outlooks are disturbed by the apparently increasing tendency to conduct our affairs in large units. The America that many prefer is the America of small businesses, independent family farms, intense competition, individual responsibility and limited government.

The America that they see around them is something else again. In that America a very large proportion of manufacturing is controlled by very large corporations, which in some instances employ hundreds of thousands of workers and register sales in the billions of dollars. In such industries as autos, aluminum, steel, electrical appliances and equipment, chemicals and rubber tires, three or four industrial giants constitute the bulk of the industry. Inevitably, the rivalry among these colossi must differ in kind from the competition among thousands of economic atoms which once represented the economist's dream of a perfect market. The power which such size must imply may be abused, as was demonstrated in last year's price-fixing scandals in the electrical industry. But even when it is not abused, the perfectly proper investment and location decisions of the industrial giant transform the lives of individuals, communities and entire regions.

Large-scale unionism has aroused similar apprehensions. The occasion for concern is much more than the existence of such authoritarian leaders as James R. Hoffa. Even when the union head is as responsible as a Walter Reuther and the union as decently run as the United Automobile Workers of America, the most fair-minded is likely to be disturbed by the sheer concentration of economic muscle in the million-member union. Quasi-compulsory union membership and the frequent absence of internal union democracy enlarge the scope of union control over the economic lives of its members. Like the large corporation, the large union frequently resembles a private government.

ALMOST inevitably the inseparable companion of big business and big labor has been big government. The sheer, crude size of the federal budget, now edging toward $90 billion annually, exercises tremendous influence throughout the economy. One of the dangers of big government is in the possibility of its alliance with private interest groups. Presumably Mr. Eisenhower had this prospect in mind when he warned, in his final remarks to the American people as their President, against too close an affiliation among the military, defense contractors and interested civilian officials. Certainly the new defense budget in excess of $46 billion intensifies this possibility.

The regulatory agencies influence the flotation of new securities, the transportation of passengers, the pricing of electrical energy, the labeling of food, the honesty of advertising and a great many other private activities. The welfare agencies set the standards for local administration of relief, aid to the aged and the dependent, and payment to the unemployed.

PERHAPS enough has been said to indicate the occasion for the present debate about aims, goals and objectives. It is both natural and healthy for a people to seek an identification of the strength in its national life when external forces menace and internal changes alter its meaning.

What has emerged from this continuing discussion? Complete agreement upon our targets has not, of course, been achieved. It is not, however, too early to sort out the different kinds of goals which the argument has thus far identified. These goals relate to the framework of economic life, the expansion of national product, and the reallocation and redistribution of that product. Let us consider each of them.

The production and consumption of economic goods occurs within a framework of law and government, which set the rules and established the milieu within which individuals make their choices. In one version of a proper framework, the national goals emerge from the interplay of individual goals. Thus the "proper" rate of economic growth is thought to be the consequence of individual preferences for work and leisure. The level of employment is thought to be substantially the result of the willingness of employers to offer employment at various wage rates and the attitudes of employees toward working at these levels of remuneration. Much of the argument, in fact, revolves about the plausibility of these assumptions and the framework based upon them in a society of large unions, corporations and government.

Those who most strongly doubt the plausibility of this framework frequently prefer alternative ones which enlarge the regulatory and stabilizing functions of government. They thus assume that large scale is the inescapable consequence of modern technology, growing population and the complexities and interdependence of contemporary life.

At the other extreme are to be found the wistful who would heroically turn the clock back to a simpler

age. Echoing at some distance the philosophy of the late Justice Brandeis, they would break up big business and restore an older form of competition, curtail national unions and deprive government of its welfare functions.

John Kenneth Galbraith tried to come to grips with the problem in his concept of countervailing power. He envisaged the appropriate framework of American economic life as the balanced rivalry of large organizations of many kinds—the restraint of buyers upon sellers, unions upon corporations, and government upon all inordinate sources of private power. With considerable optimism, Galbraith anticipated the same consequences from the mutual checking of U.A.W. and General Motors, and A & P and its suppliers, as the older form of atomistic competition produced.

SOMEWHERE in between Brandeis and Galbraith is the balanced evaluation of a Clark Kerr, particularly in the essay "Organization of the Economy" which he contributed to the volume *Goals for Americans*. Mr. Kerr's framework envisages eight goals, each connected with the distribution and exercise of economic power. Tacitly accepting large size as inevitable, Mr. Kerr's main concern is to make it tolerable. Hence he advocates the encouragement of as many power centers as possible; a balance among these centers; a separation among the power centers; maximum individual choice within each center; membership control over their leaders; an "adequate judicial system" within each power system; minimum control by each union or corporation over the lives of members and employees; and government action which emphasizes procedures rather than substantive issues. As Mr. Kerr put the last objective, ". . . instead of regulating prices, the government should seek to regulate mergers and the like; instead of regulating wages, the government should provide appropriate guidance to the process of collective bargaining." Even here questions of detail, emphasis and scale leave much room for controversy.

As the political campaign of 1960 implied, and the Rockefeller Report emphasized, another important goal is to step up the growth rate of our economy. Here the focus is upon the encouragement of the private and the public initiatives which will advance the economy at some desired rate. While there is nothing sacred about the number, a five per cent annual growth in total output has often been taken as desirable. As the Rockefeller Report on the economy put it, ". . . unless we achieve a five per cent growth rate, we shall have to hold back otherwise desirable expenditures in the government field and keep the growth of private expenditures below a level commensurate with our aspirations."

While the Rockefeller Report relied basically upon private enterprise to produce the growth rates required by our defense, welfare and investment requirements, it proposed to

Ambassador Galbraith

alter somewhat the framework of government activities in order to promote that rate of growth. Its chosen instruments were: tax reform, aid to science and technology, more sensitive antirecession policies and closer attention to the threat of inflation. In a free society, growth itself is an intermediate goal. Beyond growth is economic welfare. The gains of welfare are realized partly in private command over goods and services, and partly in increased public assistance to education, social insurance, health programs and urban housing.

Some economic goals emphasize reallocation of existing resources and redistribution of existing income. A most obvious example is the grim possibility that a heightening of international tensions may force still further increases in armaments. If these are financed responsibly, taxes will rise and resources will be diverted from individual consumers to the government. In the train of this reallocation, labor will shift from the production of autos and other consumer durables to the manufacture of armaments. As a consequence, private standards of life will decline.

Such a reallocation is only partly within our own control. But other reallocations are a matter of our free choice. Thus, a Walter Reuther often argues as though wage rises and profit decreases are in themselves good things because they tend to promote greater equality of income distribution. This is a traditional liberal objective. A diametrically opposite position is taken by many business groups who feel that the high degree of progression in income tax rates should be diminished and, implicitly, the inequality of income distribution be permitted to widen somewhat. The familiar argument is based on the need to stimulate saving and investment and the hypothesis that current levels and modes of taxation retard economic growth.

THE SHARPEST contrast in reallocative goals might be expressed as the Galbraith-Goldwater choice. In *The Affluent Society*, Galbraith identified as an appropriate national economic goal an increase in the share of the gross national product collected and expended by the federal government and a corresponding decrease in the private sector of the economy. In an argument which has aroused many challenges by other economists, Galbraith maintained that the problem of mass poverty has vanished, that consumers derive rather little gratification from much of their expenditure on private goods and services, that the public sector was shamefully neglected, and that much greater social utility would flow from emphasis upon the public sector. The natural consequences of Galbraith's position include larger public programs of urban renewal, recreation, medical care, cultural assistance, aid to education, and the like. The resources would be shifted by the payment of higher taxes.

In almost every respect, Sen. Goldwater's position is the opposite of

Galbraith's. As he perceives the conflict between private and public spending, the central point is coercion. Government differs from private agencies because it uses force to collect its revenues and fails to appeal to the free market for guidance on what consumers want. Because a free market for government services cannot exist, it is hard to estimate the relative productivity of government activity and almost impossible to check governmental inefficiencies. Although government may or may not be malevolent in its intentions, it employs coercion wherever it acts, impedes free choice, impairs individual energy and produces inefficient consequences. Hence government should be restricted to minimum functions.

What would be implied by a limitation of government to those functions which private enterprise could not be persuaded to undertake? One casualty would be economic subsidies to such special interest groups as farmers, veterans and shipbuilders. A second would be housing and other predominantly urban programs. The conservative argument concentrates upon private markets and private demands. If housing is inadequate the cause is not the inadequacy of governmental programs but the inadequacy of private demand, the discouragement of private enterprise by unions and taxes, and the superior attractions of other outlets for investment.

No one category of national goals has won complete acceptance. Our political parties are coalitions of many interests and our election campaigns are waged over many issues. In recent elections, the nature of our economic framework has been one of these issues. While generalizations about either Democrats or Republicans are unwise, it is probably fair to say that most Democrats tend to favor somewhat greater controls over private activity than do most Republicans. The difference is most striking in such areas as housing, public power and resource development, and the powers of the regulatory agencies.

Economic growth has won more adherents than any other single objective. Whether the emphasis is upon the Russian threat, the needs of the underdeveloped countries or our own unfinished business, rapid economic growth is seen as a long step toward a solution. But as soon as questions of means present themselves, agreement ceases. Should growth be stimulated only by means which are consonant with the present role of the private economy? If most expansion is public, has real economic growth taken place? Questions of this variety intimate just how far from a conclusion the discussion of economic growth is.

Reallocation and redistribution are the touchiest subjects of all. Major bargaining negotiations between large unions and leading corporations are really arguments about the allocation of a growing output. Many Congressional debates implicitly focus upon the place where the

Senator Goldwater

tax burden is to fall and the area where the benefits of government spending are to be enjoyed. The absence of agreement is entirely natural. Even if the Galbraithian position were to win general acceptance, argument would not cease. For many liberals who accept Galbraith's statement of public needs demur at his recommendation that these needs be financed by sales taxes.

Are these goals consistent? The answers are variable and arguable. No doubt different frameworks will lead to different rates of economic expansion. An example of the uncertainty of the situation is this: if we concentrate upon the establishment of a highly libertarian framework, we must forego explicit national concern with reallocation and growth. Will growth be less or more rapid as a consequence? There are arguments on both sides. Will a framework which embodies a higher degree of public action and a tighter control over recession promote higher average levels of growth and easier achievement of reallocative goals? Again there is no certain answer.

If growth is emphasized, we may find ourselves altering our governmental framework in order to achieve this goal. But once more it is in the *distinctions* that the heart of the argument lies. We may favor growth in general, or growth in a particular area. If it is the latter, we must vary tax policies and other governmental regulations to achieve our aim. Perhaps we shall require direct federal investment in housing, schools, dams and parks.

If we prefer to emphasize the goals of reallocation, we may have to sacrifice framework and expansionary objectives. Again much will depend on the nature of reallocation. Some reallocations will discourage saving and enterprise, and, in the absence of government spending, reduce economic growth. Others may well promote saving and investment.

Thus, as the national debate over the appropriate economic goals of a democratic society continues, it is plain that a considerable area of choice remains. Not all the possibilities are equally probable. Despite the hopes of wistful conservatives, we have little chance of returning to the 19-century days of small business, small government and weak unions. We are no more likely to deprive the federal government of welfare functions that have now become traditional. The repeal of the income tax is not a foreseeable possibility.

When this is said, a considerable range of possibility still remains. The boundary line between private and public action is subject to deliberate drawing. Within fairly broad limits, we really can select the governmental framework of our economic lives, choose the rate at which we prefer to grow and select the mode in which we care to allocate our economic resources. The continuing debate will have much to do with the choices that ultimately emerge. ■

The Challenge of Coexistence

by GUSTAV RANIS

► *Foreign aid, which was considered a temporary program in the early postwar years, has become a permanent fixture in the federal budget. As a consequence, it is subject to constant reappraisals of its necessity and effectiveness. Although* DR. GUSTAV RANIS, *a member of the Economics Department at Yale, has a few doubts about the program's effectiveness in certain areas, he has none about its necessity. He feels that the peoples of the underdeveloped areas will ultimately choose our system over that of the U.S.S.R.—if "the choice can be made on a full stomach."*

THE GROWTH RATE of our domestic economy has become a subject for parlor games even in nonelection years—and growth abroad, both in Western Europe and in the less developed countries of Asia, Africa and Latin America, has become a central concern of our foreign policy. In fact, the "dismal science" hasn't had as exciting a subject to deal with since the "Keynesian Revolution" of the Thirties.

Our concern with growth in the less developed areas in particular has resulted in a heavy commitment of our resources; it has been virtually built into our annual budget. There is no longer any talk of a temporary program carried on by temporary agencies. Having gone through the era of ECA, FOA, MSA and nearing the end of ICA, there is probably more concern with an exhaustion of the alphabet than with our adherence to the foreign aid principle.

Since 1945 more than $80 billion has been spent on foreign aid. The lion's share has gone into the postwar reconstruction of Europe, and into military aid and general budget support in such areas as South Korea, Taiwan and Viet Nam. The emphasis on economic development, however, really began in 1949—albeit in a very small way—with President Truman's Point Four declaration. Since that time, aid for economic development, although it enjoys the overwhelming support of both political parties, has been subjected to more criticisms, appraisals and reappraisals than perhaps any other government undertaking in memory.

A major and perennial issue concerns the amount of aid and the method of allocating it. The extent of the program is, of course, largely dependent on the strength of the antiaid forces in Congress—whose primary concern is not the aid program so much as the size of the federal budget. But even when we make up an aid "package," such as the $500 million now set aside for Latin America under the "Alliance for Progress," criteria of some sort must be evolved for distributing it among different nations.

Among the criteria which have been advanced is the allocation of funds so that they: (a) make per capita national income grow at the highest possible rate, (b) help to narrow present international per capita income differentials, (c) permit the guarantee of a given annual percentage *increase* in per capita income levels to all countries concerned.

On closer examination, none of these seemingly scientific criteria is completely satisfactory. If we followed rule (a) we would presumably spend all aid funds in the wealthiest countries—i.e., the ones that need it the least, a procedure somewhat contrary to our foreign policy objectives; if we followed (b) we would concentrate on putting all our resources into the most laggard countries in a presumably costly and fruitless effort at "bringing up the rear"; and if we chose (c) we would in fact be rewarding "bad behavior" by recipient countries who would be guaranteed a given rate of growth regardless of the extent of their domestic effort and discipline.

It is, in fact, the extent of the effort put forward by the aid recipient which was suggested as the relevant criterion in the Administration's recent attempt to put foreign aid on a long-term basis. Since economic development is patently dependent in large measure on a country's commitment to growth, allocation criteria based on performance have a good deal of intuitive appeal. The difficulty, however, lies in selecting performance standards which are not arbitrary.

In addition, there is the problem of ensuring that high-level governmental commitments get translated into ministerial or legislative action and into policy implementation at the working level. The commitment to increased taxation in Pakistan's First Five-Year Plan, for instance, was quite meaningless without Finance Ministry approval, and Iran's land reform legislation remains ineffective without the will to implement it.

Some years ago Professors Millikan and Rostow of Massachusetts Institute of Technology sought to solve this problem by proposing what seemed at first blush a neutral and scientific allocation criterion. Their idea was to allocate aid on the basis of a country's so-called "absorptive capacity"—i.e., its ability to effectively blueprint and implement specific development projects and thus make effective use of foreign aid contributions. Basing their calculations largely on India, Millikan and Rostow came up with the reassuring conclusion that a doubling of our total annual aid program would approximately serve to satisfy all "legitimate" aid requests around the world. Unfortunately, however, while absorptive capacity is admittedly a relevant concept, it is extremely difficult to define precisely.

A NATION'S economy cannot, of course, progress by capital inflows alone. But we must also remember that it is extremely difficult to determine the point at which additional funds cease to be effective. Absorptive capacity "ceilings" may well be amenable to change through the deliberate development of such

funds in institution-changing directions.

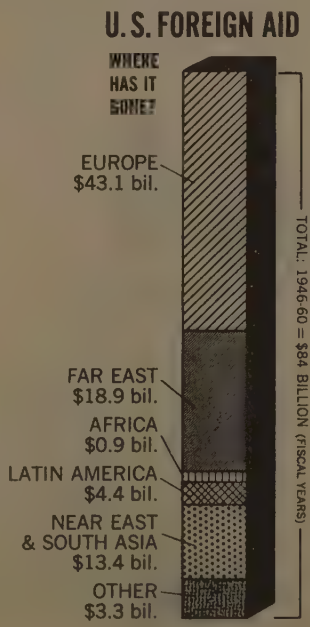
Another problem which has beset out foreign assistance programs is the precise form in which aid ought to be given. As is well known, we have witnessed a remarkable proliferation in aid techniques and, consequently, in agencies entrusted with the task. Technical assistance, the initial "hard core" of the development program, is administered by the International Cooperation Administration (ICA). Economic aid proper is now mainly in the form of soft loans and is administered by the semiautonomous Development Loan Fund (DLF). Agricultural surpluses, part of the aid program under Public Law 480, are jointly administered by the Agricultural Attache in the U.S. Embassy, the local ICA Mission, and, for some categories, the Export-Import Bank. In the case of countries with which we have military alliances, there are the additional categories of military aid proper (mostly hardware) administered through Military Advisory Groups and defense support (usually in the form of commodity aid) administered by the ICA. Finally, there are substantial special and contingency funds for use at the President's discretion.

UNDER the newly created Agency for International Development (AID), ICA and DLF—which were pulled apart only a few years ago—will be reintegrated. If the objective, as announced, is to streamline the aid-giving apparatus, this proposal does not seem very far-reaching. In addition, one might question the "semi-autonomous" status of the new Peace Corps and the significance of an elevated and expanded Food for Peace program. With respect to the Peace Corps, in particular, one wonders about the advantages of disassociation from experienced aid agencies, without the benefits which complete disassociation from government might have bestowed.

Obviously, such a variety of foreign aid "windows" perplexes the aid recipient in his dealings with "the" United States government and renders the task of arriving at an internally consistent and well-coordinated total aid package exceedingly difficult. What results all too often is a "shopping around" among various competing agencies and the abandonment of any attempt to arrive at a comprehensive national development plan. Agreement on a particular item in an aid program is bound to be quite meaningless if it is reached without due regard to the available resources (both foreign and domestic) and their proposed allocation.

It must be remembered that regardless of the form it takes, the recipient government is the ultimate beneficiary of aid. It is not always easy, however, to determine which sector of its economy is benefiting the most from each type of assistance. Aid destined for the military, for example, may enter in the form of food, thus releasing domestic resources from food production and freeing them for defense. Conversely, the arrival of military hardware may ultimately represent an addition to industrial capacity if it takes the place of equipment which otherwise would be bought with domestic resources. These resources would then be freed for investment in industry.

In short, we can approximate the consequences of a given conglomerate aid package (e.g., Does it raise military potential? Does it increase consumption? Does it increase the capital stock? etc.) only if we know, or can estimate, what the economy *would have done* in the absence of this particular form of aid. This, of course, is not an easy question to answer. But it does underline the need for an internally consistent aid package negotiated in the light of agreed-upon levels of domestic effort in the recipient country.



The long-ranging controversy concerning military vs. economic aid obviously represents only one aspect of this larger picture. Admittedly we may not be able to determine precisely whether or not Pakistan's military establishment would be large enough to serve our strategic purposes if we did not offer her an import surplus in the form of military aid and defense support; but, although Pakistan gauges her needs mainly by assessing the danger from India (rather than from the North), we can make a very reasonable guess. This, then, permits us to make the following type of inquiry: Why do we give "economic aid" to India—and thus permit her to buy jets in the open market—while Pakistan receives the bulk of her aid package in the form of "defense support" and "military aid"?

The same result could perhaps be achieved without creating an unfavorable image of us in India, where we are accused of arming Pakistan against her, as well as in Pakistan, where we are thought to be insufficiently interested in economic development.

ANOTHER QUESTION which has generated a great deal of excitement is the propriety and effectiveness of attaching "strings" to our aid. Here it might be useful to distinguish between the two kinds of conditions usually discussed (though they are very much interrelated): technical strings to safeguard the proper use of foreign aid funds, and political strings to ensure compliance with U.S. foreign policy objectives.

There are those who insist that the imposition of mutually agreed upon restrictions on the end use of aid really constitutes an obligation on the part of our government to the U.S. taxpayer. Others concentrate their fire on the political alignment of aid recipients in the cold war and insist that a U.S. policy of assisting both neutralists and allies is unten-

able. Still others contend that we ought to have no strings of any kind since recipient countries resent such invasions of their sovereignty and we are likely to find ourselves in the position of taking away more with one hand than we are bestowing with the other.

It would seem that this whole question of the presence or absence of strings is really a largely fictitious issue; what really matters is the skill or adroitness with which strings are applied. On the technical side, although the incidence of graft, corruption and inefficiency in the administration of our aid program abroad has undoubtedly been exaggerated, there have been admittedly bitter experiences and no one is likely to dispute our right to insist on a minimum set of operational standards. On the political side, moreover, I don't think there is anyone in either the United States or in the recipient countries who really believes that a divorce of aid from foreign policy objectives can really be accomplished or that aid relations may ever be viewed as uncontaminated with the "grimy business" of power politics and the cold war. Everyone knows that the "stringless" aid of the Russians is, in reality, simply a different species of the same animal. What is objectionable is not the existence of strings but the induced controversy. Some critics complain that we have neglected the common man and poured unconscionable amounts into building up the urban centers of the elite; others have said that our aid is too narrowly "economic" and not sufficiently responsive to the emotional needs of the recipient countries. In addition, there is the issue of short-term assistance, implying the retention of maximum flexibility vs. long-term or relatively fixed commitments over a period of several years.

All such issues are of course relevant and highly important. But there is also a prior question which is seldom asked and which is nevertheless basic to the consistent resolution of these problems—and that is the simple matter of the long-run policy objectives of the United States in the field of foreign aid. There has been a good deal of emphasis on the role of traditional American impulses to assist those who are less privileged, and I am sure there is an element of this imbedded in our aid programs. Our detractors claim that we require foreign aid to give us a "vent for surpluses" and thus keep our industries humming; I think we can give short shrift to this one. But mainly our foreign aid program is, I think realistically, viewed as an antidote to communism and as a *bona fide* weapon in the cold war arsenal.

eptness with which we have so often applied them in the past. In order to receive a *quid pro quo,* in other words, it is not usually necessary, or wise, to demand that countries take public action to align themselves with a specific Western policy—as happened in the embarrassing cases of Indonesia and Burma some years ago.

Other issues related to our foreign aid program have periodically in-

But reaching beyond all explicit or implicit motivations, what, as a matter of strategy, are our policy targets? Are we interested in an international redistribution of wealth, or in taking the economies of the less developed nations all the way to the promised land where growth is assumed to be effortless and automatic? Have we ever really concerned ourselves with the fact that, perhaps, successful development cannot be equated with stability—or with regimes friendly to the West?

Here, as in so many other areas, the United States has had responsibilities thrust upon it by circumstance. We have become the principal provider of developmental capital in an endeavor which is itself revolutionary in concept. Yet we are by nature a businesslike people, not much given to contemplation of the long-run or of the philosophic implications of a particular policy. In the case of the Marshall Plan, the job was clearly enough defined and we could roll up our national sleeves and go to work; it took less than 10 years to accomplish the objective of restoring war-ravaged European lands to their prewar levels of per capita production.

Then, as attention shifted to the less developed areas, we had a natural inclination to roll up our sleeves once again and transfer our previous experience. As a result, it is perhaps fair to say that we assumed our present role as perennial donors of development capital without ever facing up to the basic issues involved.

Psychologists might be able to explain all this as a form of "national repression" resulting from an uneasy feeling in the back of our minds that the answers are not likely to be pleasant. For example, even if these countries are successful in accelerating their development beyond anyone's expectations, the gap between them and us is bound to widen. Even if annual per capita income rates of growth—now customarily at one per cent or two per cent —were doubled, it would take Pakistan 15 years to reach Ceylon's present per capita income level; Burma by then would have reached the level of present-day Thailand and India half that of present-day Turkey.

It is, I think, essential that we reach an understanding of the immensity of the task we have taken on and thus prepare ourselves psychologically for the long years of seeming failure and frustration which inevitably lie ahead of us.

It is also of the utmost importance that we have a sense of realism concerning the, at best, marginal role which we can play in assisting this developmental process. Ultimately growth must be based on a country's

own efforts, and we ought to realize that our potential contribution casts us in the role of a mosquito on the back of an elephant. This doesn't mean that an intelligent application of our "sting" can't make the elephant walk faster. But this is clearly not a field for woolly thinking and more or less felicitous phrase making. We are clearly in for a long, hard pull, and the earlier we realize it and explicitly state our long-term aims and objectives, the better off will be all parties concerned.

Finally, in fighting the cold war by means of our assistance programs abroad, I don't believe we should try for temporary popularity. By now we should have matured sufficiently as a nation not to *expect* to be liked in return for our aid. The citizens of the recipient countries are going to be our poor cousins in what is a natural conflict situation for many years to come. And there is nothing in the color of our skin or in the history of our past to particularly endear us to them.

If the Russians build bakeries and pave the streets of Kabul—and then reap the propaganda harvest—while we engage in unspectacular development projects in the outlying areas, there is relatively little we can do about it. We can't hope to compete with them successfully on that level; they'll surely always be better at it than we are. Nor are local leaders, given enough time, as unsophisticated about these matters as we sometimes seem to assume, and a "tough" but intelligent aid program may well serve to strengthen the hand of such officials.

Admittedly, an inflexible, narrow economic approach which ignores a people's immediate material desires may not be the answer. But I would argue that an opportunistic approach to aid is an art which we are unlikely ever to master and one which is likely to boomerang on the artist. We can do no other but to help these countries develop as best we know how.

What we have to count on is faith in the ultimate competitive strength of our system of values—when the choice can be made on a full stomach. And here history—given a longer perspective—is on our side and not, as is often claimed, on the side of our antagonists. ■

The future of the labor movement

Don't Count the Unions Out

by IRVING BERNSTEIN

► *Many labor experts feel that unions have reached an "organizational plateau" and that membership will decline as workers continue to shift from manufacturing into service occupations.* DR. IRVING BERNSTEIN, *Associate Director of UCLA's Institute of Industrial Relations and author of* The Lean Years: A History of the American Worker, 1920-1933, *dissents from this view.*

IS THE American labor movement in trouble? A. H. Raskin, *The New York Times* labor correspondent, says yes. He recently wrote: "Each day brings compelling reminders that labor's strength is on the downgrade and that, like the colonial powers of Europe, its leaders may soon be presiding over the dismantling of their . . . empires. . . ." Daniel Bell, former labor editor of *Fortune* and such respected labor economists as Richard A. Lester of Princeton and Neil W. Chamberlain of Yale would also concur with this opinion.

These and other authorities find much evidence that union strength is waning. They point to automation and intensified foreign competition—problems that defy solution through collective bargaining, labor's traditional pathway for meeting its problems. They note the labor movement's major internal difficulties —corruption, jurisdictional conflicts between craft and industrial unions, and the fact that many union leaders are older men set in their ways.

Those who prophesy doom for the labor movement point to statistics that purport to show that union membership has long since stopped growing—and may have actually declined. They reason that the unions have reached an "organizational plateau" in their traditional strongholds, since most of the blue-collar workers in the large manufacturing, mining, transportation and construction industries of the urban North and West are already organized.

Consequently, unions must now attempt to organize women, white-collar workers, employees in the wholesale and retail trades and in the services, people in the professions, in government, in little firms, small towns and *the South*. But most observers of the labor scene are pessimistic about the ability of unions to organize large numbers of these people. And they become even more pessimistic about labor's future when they consider that an ever-growing percentage of the labor force is shifting from blue-collar to white-collar employment.

In my view, the statistics on union membership do not support such a gloomy prognosis. I feel that union penetration of the so-called "impenetrable" sectors of the labor force is already under way.

As the figures in the table on page 18 show, the membership in American labor unions rose from 13,379,000 in 1945 to 18,607,000 in 1960, a gain of 5,228,000, or 39.1 per cent in 15 years. Certainly, this represents a substantial achievement. Furthermore, over this period, what is termed "real" membership (union membership as a percentage of the civilian labor force) advanced from 24.8 to 26.2 per cent. *Thus, there is no basis for arguing that the labor movement has not grown since World War II.*

Actually, the problem of stagnating union growth has only emerged in the past half-decade. All the gains noted above took place between 1945 and 1956. By the latter year, American unions had 18,477,000 members. Between 1956 and 1960 actual membership remained stable at about 18.5 million, the exception being the recession year 1958, when it fell to 18,081,000. During this five-year peri-

od, however, since the total labor force was expanding, "real" membership fell from 27.4 to 26.2 per cent.

WHY DID GROWTH stop in 1956? Basically, *the rate of increase in employment perceptibly slowed down.* Between 1945 and 1956 nonagricultural employment rose from 44,240,000 to 58,394,000, a total gain of 14,154,000 and an average annual increase of 1,286,700. Between 1956 and 1960, on the other hand, nonagricultural employment advanced only from 58,394,000 to 61 million, a rise of 2,606,000 and an average yearly increment of but 651,500. It is hardly a secret that during the last six years—in both good times and bad—the United States has suffered from persistent unemployment. The unions have been among the principal victims.

In fact, union membership of late has been unusually concentrated in the manufacturing and mining industries—areas which are most sensitive to fluctuations in employment. In the late Fifties one out of two union members was in manufacturing or mining. Prior to World War II the ratio was one to three and it was probably even lower in the more distant past.

But, since 1956, employment in both of these industry groups has declined significantly. Hence many of the unions in these sectors have sustained losses in membership—the United Auto Workers, the Steelworkers, the International Union of Electrical Workers, the Rubber Workers, the Woodworkers, the Textile Workers and the United Mine Workers. To this group should be added most of the railroad brotherhoods, which have been operating in a declining industry largely dependent upon manufacturing and mining.

Union corruption is a second reason why membership has failed since 1956. This has been the era of the McClellan Committee revelations, which have blackened the public image of the labor movement. The slowdown in employment, however, was certainly a more important factor in declining union membership. The Teamsters, who suffered most from the exposures, actually *expanded* their membership after 1956.

Union membership as a whole would have declined between 1956 and 1960 if losses due to these two factors had not been offset by gains elsewhere. While membership fell in manufacturing, it rose in nonmanufacturing industries—excepting, of course, mining and the railroads. Unions have made gains in construction, air and truck transportation, retail and wholesale trade, entertainment, building service and government, especially state and local. These industries fall predominantly within the sector of the labor force which is felt to be "impenetrable" to union organization. This suggests the need for a close look at the hypothesis that the strength of labor unions is waning.

FIRST OF ALL, are women less inclined than men to join unions? It is true that women are presently less well organized: in the mid-Fifties only 16 per cent of the women in the labor force were union members in contrast to 31 per cent of the men. Moreover, the proportion of women in the labor force is rising: it increased from 17.7 per cent in 1900 to 30.3 per cent in 1955. Ewan Clague, the Commissioner of Labor Statistics expects women to compose 33.4 per cent of the labor force by 1965.

Many claim that women, because of their interest in marriage and childbearing, are less concerned than men with union membership. But Clague's projection assumes that most of the increased participation in the labor force will be among married women over 35—that is, among those who have already borne and raised their children.

In fact, we know nothing about the comparative propensity of men and women to join unions. It would seem that the economic and social forces that shape the decision work on both sexes. Hence women could turn out to be as indifferent or as militant unionists as men.

The difference in the membership rate is to be explained largely by the fact that women work primarily in industries and occupations into which unions have not penetrated deeply—office, sales and services. In these sectors, they find no disadvantage in having a large female membership. Local 770 of the Retail Clerks, for example, which represents employees in the Los Angeles food and drug markets, considers its women members to be the backbone of the union.

SECOND, do unions, which have in the main organized large corporations, now face a tougher proposition in organizing small firms? It may not, of course, be necessarily true that it is easier to organize a large firm than a small one. A big anti-union employer, obviously, has greater resources than a little one. Unions that have sought to organize

UNION MEMBERSHIP, 1945-60

Year	Actual Membership	Per Cent of Civilian Labor Force
1945	13,379,000	24.8
1946	13,648,000	23.7
1947	14,845,000	24.7
1948	14,916,000	24.3
1949	14,960,000	24.1
1950	14,751,000	23.4
1951	16,211,000	25.8
1952	16,730,000	26.6
1953	17,884,000	28.0
1954	17,757,000	27.5
1955	17,749,000	27.0
1956	18,477,000	27.4
1957	18,430,000	27.1
1958	18,081,000	26.3
1959	18,452,000	26.6
1960	18,607,000	26.2

THERE IS NO official internally consistent series of national figures on union membership. Thus, the author has constructed the adjoining series by piecing together (a) figures for 1945-48 compiled for the National Bureau of Economic Research by Leo Wolman, (b) Bureau of Labor Statistics' data for 1954-58, and (c) his own projections for the missing years. He feels that, although this method would hardly satisfy a conservative statistician, the results are historically meaningful. These statistics, it should be noted, exclude union members in good standing who do not pay union dues (probably over one million), exclude members of unions limited to a single locality or employer (1.5 million), and include foreign and territorial members of American unions (1.2 million).

the large oil and chemical companies can attest to this.

The great majority of NLRB elections that unions have won in recent years have been in units with fewer than 100 employees. Union representatives in both manufacturing and service industries have informed me that they could organize many small units if they wished. Whether or not the job can be done is only part of the question; more often the problem is whether the expenditure in time and money can be justified by the potential return. Since many unions, including the AFL-CIO, have been working under restricted budgets, this question has usually been answered in the negative.

THIRD, is it difficult for unions to organize in small towns? Again, it is not an assured fact that big cities are better organized than little ones although, in general, this is probably true. But exceptions come readily to mind. In California, for example, Fresno and Bakersfield are more highly unionized than Los Angeles. Further, the industrial spillover from cities to satellite communities in expanding metropolitan areas has brought unionism to many small towns.

On the other hand, the atmosphere of a community influences the ability to unionize. For all practical purposes, there are no longer any large cities in which antiunion sentiment predominates. Some small towns of this sort remain, largely in the South and Plains states. However, this does not of itself prove that small towns are harder to organize.

FOURTH, are government employees hard to unionize? Certainly, it is true that public workers are not as highly organized as those in manufacturing, mining and transportation. Yet membership among government employees has been rising. There are many reasons: the narrowing of historic fringe benefit differentials between the government and private industry, the growing variety in public employment, the increased willingness of public agencies to experiment with collective bargaining and the shift of some properties, especially in local transit, from private to public ownership. The State, County, and Municipal Employees is the fastest growing union next to the Operating Engineers.

FIFTH, does the South present a formidable barrier to unionization? Here analysis is hobbled by the virtual absence of statistics. But available information suggests that unionization among Southern factory workers has been increasing, and that in Texas both manufacturing and nonmanufacturing industries are organized to a significant extent. Students of the problem have emphasized that unions tend to make gains in large new industrial plants and to meet defeats in older, smaller establishments. Thus, as the South has industrialized, unions have gained.

Certain unions, especially the Teamsters and District 50 of the United Mine Workers, have invested in vigorous organizing campaigns in the South with considerable success. Still, there are several Southern industries into which unions have failed to penetrate deeply—textiles, hosiery, lumber and furniture. Unionism is still very weak in some Southern communities.

FINALLY, is there a white-collar bar to unionization. The American labor movement in membership, leadership and tradition is predominantly blue collar. In 1958 only 12 per cent of union members were in nonmanual occupations. Of the 29 persons on the AFL-CIO Executive Council at that time only two were from white-collar organizations. But the labor force is undergoing a shift from manual to nonmanual work. In 1956 the number of white-collar workers for the first time exceeded the number of blue-collar workers and there is every prospect that the trend will continue. For this reason the organization of white-collar people is the basic challenge to the labor movement. It must unionize them or decline in size.

It is a mistake to regard white-collar workers as a monolithic group. A professional engineer, a motion picture star, a doctor, a railway clerk, a telephone operator, a postal clerk, a checker in a market, a secretary, have as little in common with each other as they have with manual workers. They are divided by differences in education, income, employment regularity and status, all of which shape their attitude toward unionization. Furthermore, the shift to white-collar employment has been uneven from industry to industry. In manufacturing, for example, the percentage of manual workers has declined far more in aircraft than in textiles. Thus, it is hazardous to generalize about the organization of white-collar workers as a whole.

The labor movement has had a small, traditional base in nonmanual occupations on the railroads, in telecommunications, in the post office and among professionals in show business, on the airlines and on newspapers. In recent years this base has expanded. The growing organizations have included the Air Line Pilots, the Railway Clerks, the Teamsters, the Retail Clerks, the Retail, Wholesale Union, the Butchers, the Musicians, the Screen Actors, TV and Radio Artists, the postal organizations, and the State, County, and Municipal Employees. In 1961 the City of New York certified a union of 1,040 doctors and dentists in the Health Department. Moreover, more than 8,000 registered professional nurses were covered by collective bargaining agreements in 1960.

This is not to say that the organization of nonmanuel workers on a massive scale is likely to come about either quickly or dramatically. In all probability the growth will occur gradually. The expansionist tendencies already evident will doubtless continue and will spread to new fields. Though such areas as banking, finance, real estate and small offices may not be organized in the foreseeable future, there can be no doubt that unions are penetrating the white-collar sector of the labor force.

The American labor movement has not saturated its organizable potential. The door is not shut, locked and bolted; it *can* be opened. But that will take a great effort. The troubles that labor's critics have cited are real. The movement must resolve its internal problems and develop leaders with the imagination and the will to organize in new areas. Equally important, the unions must work beyond the collective bargaining arena for full employment. The time for testing lies ahead. But as of now, don't count the unions out. ■

Challenge Interview

The Problems of City Planning

JAMES FELT

► *The proposal to create a federal department of urban affairs at the cabinet level has focused considerable national attention on the problems of our cities. While some of these problems—housing, transportation, schools—are endemic in the very nature of cities, they* can *be alleviated through proper planning. As Chairman of the New York City Planning Commission, James Felt holds the most difficult and complex planning job in the country. He is a professional real estate man and has headed the Planning Commission since 1956.*

Q MR. FELT, *what, in your opinion, is the principal job of a planning commission in a city like New York?*

A The main function is to do whatever thinking and planning is necessary to make the city a better place in which to live, to work, to do business and to enjoy the good things of life.

Q *How long has there been a city planning commission in New York?*

A The City Planning Commission was formed in 1938. Prior to that time there was no single agency responsible for giving advanced thought to the future development of the city. In fact, prior to 1916 we had no zoning ordinance in New York City. Zoning ordinances are the city's rules and regulations governing the appropriate use of land and the degree and intensity of construction. Before 1916, for example, the proverbial glue factory could be built next door to a fine private residence.

Q *Did other cities have such zoning ordinances earlier than New York?*

A No, New York was the pioneer in this field.

Q *Was the 1916 zoning ordinance a comprehensive one, or was the present, all-encompassing plan instituted in stages?*

A It was a comprehensive zoning plan which has been amended, I believe, almost 3,000 times. Last year we succeeded in obtaining the first comprehensive amendment to the zoning ordinance which will go into effect December 15. It was first proposed by the Planning Commission several years ago and finally approved by the Board of Estimate last December. The building industry was given a year's grace to revise its plans in accordance with the new regulations.

Q *How does this new zoning plan differ from the old one?*

A It differs from the old zoning ordinance in a number of respects, and it is a far more effective instrument for planning for future population changes in the city. When I say population *changes,* I don't mean merely increases. We must also plan for population *shifts* within the city. In addition, the new regulations will permit a flexibility of design in architecture and will do a great deal to protect the people of the city so that they will have more green areas, more open space, more light and more air. It will make New York a much more livable city.

Q *Where would you say is the emphasis in the new law? Is it on* how *buildings will be constructed or on* where *they will be built?*

A The emphasis is on both the how and the where. As an example of appropriate land use—which is the "where" aspect—we want to make certain that there is not an improper intrusion of residential buildings in an industrial neighborhood.

Q *Is this really a new departure? Wasn't such a provision contained in the old zoning regulations?*

A No. Under the old zoning resolutions protection was given primarily to residential buildings. In other words, an industrial building could not be built in a residential neighborhood; but, on the other hand, a residential building could be built in an industrial neighborhood. Protection was given for residents, and that is good. But in New York City we must protect our economic base as well as our residential base, and we have found that many areas that are suitable for industrial purposes have been infiltrated with spots of residential buildings. This, in effect, pre-empted space that should have been used for the expansion of industrial facilities.

Q *Isn't it rather unusual that people building residences would want to go into industrial areas?*

A It happens with sufficient frequency to block industrial expansion. You often get one or two home builders who seek sites close to industrial areas. There might, for example, have been cheap, vacant lots in the vicinity.

Q *What kinds of problems might this create?*

A After these houses are built you find two things happening. First, as I said before, it makes it impossible for the industries to expand on an economic basis and, secondly, the people living in those houses then begin to complain about the by-products of the industrial operations and about the traffic. If the city tried to alleviate the complaints of the homeowners, it would seriously stifle the industry. We think that with proper thought we can protect both industry and residences. I think this gives you some idea of the problems that an incomplete or ineffective zoning ordinance can create.

Q *Do you have any rule of thumb, say, for the island of Manhattan, as to how much industrial space there should be, how much residential space and how much commercial space?*

A While we don't have any rule of thumb based on the individual boroughs, I can say that the new zoning ordinance is concerned with the integrated growth of the entire city. Under the old regulations there would have been enough space in New York City to take care of a population of some 50 million people. However, there is very little likelihood of our population growing much beyond the present eight million or so in the foreseeable future. In effect, there was the potential in the old zoning law of a very much greater population density than could conceivably live in New York City—by any stretch of the imagination. Under the new zoning resolution the population could be increased to 12 million rather than 50 million. While I personally doubt that New York's population will reach 12 million in the foreseeable future, at least the margin of difference is within reasonable limits and will permit us to plan the city's future realistically.

Problem of postwar population shifts

Q *While the population of the city has remained relatively stable over the last decade, there have been significant shifts among the various boroughs. How does this affect the problems of a city planner?*

A The postwar population shifts have certainly complicated the problems of city planning. Since 1950, for example, Manhattan has lost 13.4 per cent of its population, Queens has gained 16.7 per cent and Staten Island 15.9 per cent. Obviously, one of the principal problems created by this outmigration from the older boroughs is the strain on the transportation system. On the plus side, however, is the fact that our population is much more mobile than it used to be. People should have a free choice as to where they want to live. I think New York City should almost have a "department store" insofar as residential preferences are concerned. There should be areas set aside in the city for people who want to live in a predominantly suburban surrounding. I think Staten Island will provide that type of living. Some people will want high-rise apartment houses near their place of work in Manhattan. Others will want one- and two-family houses within reasonable traveling time from the city, and they may elect to live in Brooklyn or Queens. What we have to do is to keep our city viable and to have a wide arc of available accommodations to take care of everyone's preferences.

Q *I think that you will admit that some of this mobility stems from unsatisfactory conditions in some areas.*

A Yes, of course. When people leave a borough because conditions within that borough are completely unsatisfactory—slums, overcrowded schools, congestion—there's reason to be concerned. If, however, one wants to move to Staten Island because there are more open spaces there, that is good. I think what we must do is to make certain that in all of our boroughs the land is zoned to make its use satisfactory to the great majority of citizens.

Transportation a regional problem

Q *But, as we widen this arc of available accommodations, isn't the transportation problem bound to grow more difficult?*

A The transportation problem will certainly become more difficult as choice widens and people's preferences change. But I would like to emphasize that the transportation problem, and I mean the movement of people and goods when I say transportation, in New York City is something that could hardly be controlled by the city itself. New York City, as you realize, is the core of a region. The region includes 22 counties in a three-state area. This region, encompassing the area within a 50-mile radius of the center of the city, now has a population of some 16 million or 17 million people. It will probably have a population of 20 million by 1975. Many people living in the outer areas of this region use the transportation system twice daily. Others live within the city and work outside it. They also use the transportation facilities, although they create less of a problem since the outward flow is far smaller than that of the suburban dwellers who earn their living in the city. This great movement of people within the city depends not so much on what goes on in the city itself, but what goes on in this vast metropolitan region. It is extremely important that we study these problems without delay and move forward toward the best possible solution. From what I have said you can see that this requires a regional approach rather than a city approach.

Q *Do you feel, then, that we need a regional planning commission rather than a New York City Planning Commission?*

A Let me put it this way. It would probably be very difficult to develop a regional planning commission, but I think as time goes on we will hear much more about a tristate committee that has recently been formed by Gov. Dempsey of Connecticut, Gov. Rockefeller of New York and Gov. Meyner of New Jersey. The committee consists of representatives of the three states and myself as a representative of New York City. Its purpose

is to study the transportation problem in the entire metropolitan region—not just for the sake of study itself, but as a prelude to action.

Q *Would you say, then, that many of the problems you face as a planner in New York City are caused by developments outside the city's jurisdiction?*

A Yes, they certainly are. You can't separate the city from its environs any more than you can separate the vital organs from a body.

Plan for the foreseeable future

Q *Mr. Felt, when you create plans for the future of the city, how far ahead are you looking? Do you have a specific target date in mind?*

A Well, we usually like to think in terms of the foreseeable future. I would say that I think in terms of the end of this century. As a goal, let's say the year 2000 and possibly with at least one interim period, which might be 1975. There are some who would like to look 100 years beyond that, but my feeling is that if we look forward to the end of this century we are looking forward as far as we realistically can in the light of the technological changes that are bound to take place as we move beyond the foreseeable future.

Q *Do you have specific plans on your boards now for what New York City should look like, say, in 1980?*

A We are working on plans now which, in effect, might be called a master plan for the city. It indicates what we think New York should look like in the foreseeable future, and it is being constantly revised and updated.

Q *It does not, then, pinpoint a specific date?*

A Practically speaking, it can't because it has to move and change. City planning must be fluid because the city continually changes, and one must continually change a plan in order to have it consistent with these changes. The city has faced problems in the last 10 years that were certainly not foreseeable, say, in 1940. And many problems which will arise by 1975 are certainly not foreseeable today.

Q *Since the functions of the Planning Commission obviously affect the decisions of other city agencies, how do you coordinate your activities with those of other departments?*

A We have a close relationship with all of the departments involved in the operation of the city, particularly those whose functions have planning implications. This is frequently handled in connection with our annual capital budget operations. Each year various departments of the city responsible for the development of new facilities—new schools, new highways, new parks, new hospitals, and so forth—submit their budgetary requests to the City Planning Commission. We are then in a position to submit allocations to the Board of Estimate specifying the amount which should be spent by each department in the forthcoming year. We call the forthcoming year the budget year, and the subsequent five-year period is known as the program year.

Q *Would you say, then, that the City Planning Commission acts as a sort of coordinator of the budgetary requests made by the various agencies?*

A I wouldn't use the term coordinator. Let's put it this way. Each department comes to us during the late spring of the year with a list of requests. Take the Department of Hospitals, for example. They wouldn't come to us with a request for a specific amount of money. They would ask for so many new hospitals, or additions to or improvements in existing facilities. We would then review this request, as well as the requests of all the other departments. This year, for instance, the aggregate of these requests, I think, was something like $800 million or $900 million. We in the City Planning Commission receive from the Comptroller and the Mayor a statement indicating how much money is available for these purposes. This year the money available for these purposes was $385 million. We would then take this amount and determine how, in our opinion, it could be best divided, not only among the departments but for the specific projects requested by each department. We then hold departmental hearings in which each department has a chance to present its position.

Public opinion invited

Q *Is there any way for individual taxpayers to express their views on the projects?*

A Yes, definitely. After the departmental hearings, we hold public hearings where citizens are invited to give their views on our recommendations. We then submit our proposals to the Board of Estimate for its action and determination. The Board holds public hearings as well.

Q *Besides the capital budget hearings, does the Planning Commission have any day-to-day relationships with other city departments?*

A We must, of necessity, have continuing relations with most of the city departments. For example, our Commission has meetings at regular intervals with the Bureau of the Budget, the Board of Education and the Department of Real Estate to review proposals for new school sites throughout the city. Last year the Mayor set up a Housing Policy Board which acts as the official clearing house for policy problems relating to the planning and implementation of the city housing program. The Planning Commission is a member of this board. We have interdepartmental meetings with the Department of Traffic in connection with various sites that it might have in mind for garage purposes. We have almost a day-to-day relationship with the Housing and Redevelopment Board over matters that have to do with their program. This is necessary to make sure that we are not working at cross purposes. Similar meetings are held with the other principal departments. While each department is independent, we must keep each other informed of our views and our studies.

Q *What are the Commission's relationships with state and federal authorities? Don't you have to consult them on many projects which are planned for the city?*

A We do, but that relationship is not as close as our interdepartmental relationships in the city. For example, I mentioned the transportation committee that was formed by the three governors. Well, obviously, we have a very close relationship with that group. We meet from time to time with the Port of New York Authority on matters that concern both of us. But this is on an informal basis in contrast with the regular meetings that we have with the city departments.

Q *Let us take one major project as an example. What role did the City Planning Commission play in the development of the new cultural center in Lincoln Square?*

A When the original proposal for a cultural center to redevelop the Lincoln Square area was made by the Slum Clearance Committee, headed by Robert Moses, we reviewed the entire proposal to insure that it conformed to the zoning regulations in that area and that the type and density of housing that is now being developed on the site was appropriate. In our public hearings we also sought to determine whether the project could and should proceed in the light of the number of tenants who would have to be dispossessed, and the claims of tenant organizations that it would be impossible for those tenants to find other suitable quarters.

Q *Is that really a Planning Commission problem? Is it up to you to give advice as to whether there are available quarters in other sections of the city?*

A It is up to us to decide whether or not the project should proceed. Our responsibility under the City Charter is clear in such matters. One of the main problems in connection with the development of Lincoln Square was that of tenant relocation. But tenant relocation was only one of a number of questions we had to consider. In any project there are always changes which take place after the plans are approved. If we feel that the changes are inconsequential, we go along with them without public hearings. If there are changes that seem to be of consequence and of substance, then we are obliged to hold public hearings and render an opinion.

A permanent fixture

Q *Mr. Felt, do most of our large cities now have planning commissions?*

A I think it has become a permanent fixture, even in medium-size cities. New York City, however, has gone further than any other city in the country in many aspects of its future planning. However, the planning problems of New York are so complex that they cannot even be compared with those of other cities. Here we have areas ranging from the rural outlands of Staten Island to the world's largest concentration of commercial activity in Manhattan.

Q *Don't you find there is considerable resistance to city planning from people who feel that it will alter the character of existing neighborhoods?*

A This feeling definitely does exist. But we are trying to alleviate such fears by a program of neighborhood preservation. You can't map an over-all plan for the city without taking the individual neighborhoods into consideration. If you think of the Anadale section of Staten Island, the Chelsea section of Manhattan, the Bedford-Stuyvesant section of Brooklyn, you can see how *different* neighborhoods can be. As a consequence, last year we launched a community renewal program with the financial assistance of the federal government. The federal government granted $1.5 million to the Planning Commission through the City of New York which enables us to launch a program to study all of the principal communities of New York City. We are in the process of doing so now. This will give us an inventory of each area's problems and enable us to make recommendations toward a solution.

Q *Will these solutions be reflected principally through changes in the zoning ordinances?*

A They will, of course, be reflected in the zoning regulations, but they will also serve as guidelines for the Housing and Redevelopment Board, the Housing Authority, Board of Education, the Department of Parks and other city departments which must cope with particular problems in individual neighborhoods. Another advantage of the neighborhood preservation program is the direct link it gives us with the people in individual neighborhoods. In a democracy we must always consider the views of our citizens. It is not, however, always that easy to get their views. While we can't comply with all their wishes, citizens must feel that they are part of the study. Incidentally, when we speak of neighborhoods in New York, we may be referring to areas with populations as large as a medium-size city. Take Crown Heights in Brooklyn, for example. Although very few people outside of Brooklyn have ever heard of Crown Heights, this area is much larger than the city of Albany, and it is only one of 70 or 80 such communities in New York City.

Q *Do you think that a department of urban affairs, at the federal level, will help the cities with their problems?*

A I think it will help them immeasurably. I feel that it is extremely important that the federal government recognize the problems of the cities. These problems are not confined to New York or Chicago. They affect every city in the nation. It is just as important to consider the problems of urban dwellers as to consider those of the farmers. Two-thirds of our people now live in cities, and this number is growing every year. Consequently, it would be a gross injustice not to have urban problems considered at the cabinet level.

Q *Thank you, Mr. Felt.*

ARE WE LOSING LATIN AMERICA?

by CHARLES MORROW WILSON

► *Can the Alliance for Progress save Latin America for the West? What basic problems of U.S.-Latin American economic relations remain unsolved? How much ground have the Soviets gained in this vital area?* CHARLES MORROW WILSON, *a longtime observer of inter-American relations, realistically examines these and other questions pertaining to the future of the hemisphere. He is the author of several books on Latin American affairs and has received special citations from the governments of Panama, Mexico and Ecuador.*

SOME MONTHS AGO a Chilian nitrate company (Chile Antofagasto) found itself fresh out of locomotives for its narrow-gauge railroads. The company had previously suffered from Communist-inspired labor riots and vowed it would rather do business with the Devil than with the Kremlin. Accordingly the company turned to the United States with its order. But it found no American supplier interested in the expensive job of mounting a big diesel on a narrow-gauge chassis just to effect the sale of three locomotives.

So in the end the Soviet Ministry of Foreign Trade filled the small but crucial order and sent along, free, a technician to make sure the new locomotives worked. Now the formerly anti-Soviet company is also equipping its shops with some Soviet-made machine tools.

This is not a unique case. It is a fairly typical example of how the Soviets penetrate Latin America. And it is paying off. After opening their trade offensive in 1952, the Russians became, in 1954, Uruguay's number one foreign customer. This was the first time in commercial history that the U.S.S.R. could be counted as the best customer of any American nation. In 1955 the Soviet bloc carried on $150 million worth of trade with Argentina, while U.S. trade with that country fell to $200 million.

In 1958 total U.S.-Latin American trade declined by approximately 10 per cent; in 1959 it skidded another 14 per cent. While we were losing both exports and imports in 13 of the 20 Latin American republics that year, the Soviet bloc scored distinct gains in 10. Last year we slipped again. Though the statistics this year look somewhat better, we still do not have cause for celebration. In all, during the last eight years, Soviet trade with Latin America has grown by 700 per cent, while U.S.-Latin American trade has dwindled by 28 per cent.

THIS DOES NOT mean that the Communist bloc has overtaken the U.S. in volume of trade with Latin America. Their total trade figures in the area are still far behind ours and, for that matter, far behind those of West Germany, Japan, France, the United Kingdom and Canada. But the hard fact is that, percentagewise, the Communists have been making spectacular gains, while we have been losing ground. Only three Latin American countries gave the Soviet bloc more than one per cent of their total trade in 1952. But last year five per cent of Brazil's total exports went to Communist bloc nations; six per cent of the exports of Argentina, Venezuela and Ecuador went in the same direction; and 11 per cent of Uruguay's. The Soviets are similarly expanding trade in Chile, Mexico and, of course, Cuba.

Some time ago, the late John Foster Dulles reflected: "There's a discomforting similarity between Communist penetrations into economic affairs in Latin America during the 1950s and into China's during the 1930s." This comment remains uncomfortably apropos of the 1960s.

But there are significant factors of difference. In their trade relations today the Soviet bloc is far more aware of the individual needs of specific markets and of the mutual advantages of both seller and buyer than was the Kremlin in its trade "putsch" eastward during the 1930s. The Kremlin now supplements its Foreign Trade Organization (*Amtorg*) with a sort of super Chamber of Commerce. Though it has issued no formal reports since 1938, the Soviet Ministry of Foreign Trade seems to be emphasizing sales planning and promotion to an ever greater extent.

MANY PEOPLE in Latin America are distressed by these developments. They recognize the dangers of dealing with the Russians—including the danger that the products they sell to Moscow may be dumped and their normal markets thereby disrupted. They are turning to the Communists only because they believe that Communist trade is preferable to no trade.

Says a Brazilian commercial attaché in Washington: "A man tortured by hunger is no epicure. He grabs for anything edible. My people hunger for trade and in some instances the hunger is so great they take Soviet goods. We would buy these goods from the planets Mars or Pluto if they were buyable and deliverable. We much prefer U.S. goods and trade because the quality, labeling, eye appeal and other factors are much better. But when we can't get U.S. goods, or when production costs, tariffs, excises, short credit and so on price them out of our reach, we find Soviet goods better than nothing."

"The worst fault with U.S. trade," says this same Brazilian commercial attaché, "is what Shakespeare might have called a Tragedy of Errors, based on failure to check customer

needs." He cited as an example an instance from the building of the new Brazilian capital city of Brasilia. The thousands of construction workers required refrigerators for their work camps and mobile homes. They admired U.S.-made refrigerators but found them too big and expensive. They bought instead a compact West German model—without freezer compartment, chrome finish or other fancy features—whose weight and price was about half that of the American makes.

Or take another example. Recently in Buenos Aires a machine-tool service man from Vermont received a distress call from a manufacturer who complained that his newly imported Soviet power lathe had gone haywire. The Vermonter went around to see what he could do. He found the ailing Soviet machine to be an exact reproduction of a lathe which a Vermont machine-tool maker had sold to Moscow in 1936. U.S. machine-tool makers now see this particular lathe as a virtual museum relic. But many fledgling factories in Latin America prefer the outdated Soviet machine to the highly automated, more expensive tools now being produced in the United States. "We *Yanquis* have stuck ourselves on automation," the service man says. "Our southern neighbors aren't yet ready for automation. *The Commies remember the needs of their customers.*"

PACKAGING, too, is a problem. Many of our exports go south in crates, drums, hogsheads and other oversized containers which recipients find difficult to load and transport. In a small Pacific port in Guatemala I met an Indian potter who had come down from the hills with a string of burros to carry home some vitally needed pottery cement. The cement could and should have been packed in 50-pound bags. Instead it came in 180-pound bags. Almost tearfully the buyer told me, "*Señor,* these bags are too heavy. Three-bag balance packs weigh more than my burros."

Buyers of heavy U.S. machinery are frequently obliged to dismantle the equipment at the dock before they can move it where they want it. Significantly the Soviet Foreign Trade Ministry now boasts that it supplies machine tools "stripped down to convenient package size." Czech and Polish paper and barbed wire are widely used in Brazil mainly because they come in 88-pound rolls instead of the more common 200- to 500-pound rolls. Brazil also imports about 20,000 tons of industrial chemicals per month from the U.S.S.R., again because they come in packages small enough for a man to lift.

As far as exports from Latin America are concerned, the Soviet Union has an advantage over the U.S. If the goods are not needed in Russia they can be shipped off to various members of the Communist bloc. In 1958, for example, Brazil sold the Soviet bloc 9,500 tons of coffee, far more than the Russians could consume. Consequently, all but about 300 tons of the coffee was reshipped to Czechoslovakia, East Germany, Hungary, Poland and Romania.

All the 7,141 tons of Brazilian cattle hides bought by Moscow in 1958 were shunted along to the satellites, principally to Czechoslovakia; in the same year 2,600 tons of Brazilian linseed and 1,900 tons of castor seed went to Poland after having been routed through the Soviet Union. Similarly, the Soviets passed along nearly all their Argentine imports—including hides, wool, barley, corn, oats and linseed—to their satellites.

IN CONTRAST to the Soviet record, as we have already seen, U.S. trade with

Latin America has been sagging in recent years. In addition, our rate of investments has fallen sharply. Recently there have been years when Latin Americans invested more in the United States than U.S. citizens invested in Latin America. One respected economist of the Organization of American States declares that at present we're investing in Latin America only one-fifth as much as we're taking out in earnings on earlier investments.

While the rate of direct U.S. private investment in Western Europe rose by 36 per cent during the first nine months of 1960, new U.S. private investment in Latin America for all of 1960 is estimated at less than half that of 1959, and only one-sixth of what it was in 1957.

But the picture is not all black. Some U.S. companies are showing the way to a new kind of hemispheric partnership. Traditionally, U.S. corporations have operated in Latin America through subsidiaries they own outright. Now some of them encourage native ownership of some of the subsidiary's stock. Union Carbide, for example, recently sold a controlling interest in its Mexican subsidiary to Mexicans. This type of corporate partnership reduces complaints about "Yankee imperialism." It also erases, to a large extent, the hazard of expropriation and is proving good business for all.

Latin American subsidiaries of Sears, Roebuck stock their stores with merchandise from local factories, and even finance and otherwise assist these manufacturers. Most of the profits and practically all the jobs go to local people. Even so, the parent company is doing quite well. Essosa (Esso South America, Ltd.), a leading supplier of petroleum, distributes its products through 500 outlets, each a locally managed and locally financed partner of Essosa.

United Fruit is working out a system which will make 69,400 acres of banana farms in Latin America available for lease or purchase to local people, who will pay the rent or purchase price mainly from the sales of fruit harvested. The parent company supplies technical assistance for spraying, drainage, fruit

grading and other necessary details at actual cost, and buys the fruit unless the new owners elect to market their harvests independently. United Fruit believes its new policy will strengthen the economies of the countries concerned by increasing the number and competency of proprietor farmers. In addition, the company's other Latin American investments are made more secure by its new policy.

BETTER CREDIT facilities would also improve our trade position in Latin America. U.S. firms have been obliged to extend credit in Latin America at their own risk and with their own facilities. Government insurance under the International Cooperation Administration has been available but only to cover convertibility losses and losses due to political action or war. Meanwhile the Soviet bloc, Japan, West Germany, most other European nations and Canada now have much more liberal government-supervised credit insurance programs to cover overseas trade. These programs are similar in principle to the Federal Home Loan Insurance that helps lenders and borrowers in the U.S.

Because of the risk involved, U.S. creditors normally extend credit in the Americas for only 180 days or less. By contrast the Soviet bloc is offering credit for two to five years and will accept partial or almost total payment in barter. Time and time again our competitors get the orders simply because they offer more liberal credit.

For example, a contractor in Lima recently set out to build a badly needed $3.5 million water works. He wanted to use U.S.-made pipe and fittings on the project. But the reservoir had to be financed from its earnings. No U.S. supplier was in position to offer credit longer than one year; some would sell only on sight draft or at most six months. Soviet and West European suppliers have taken the business because all are in position, with government backing, to provide credit for three and one-half to seven years, long enough for the project to pay off.

Some improvement in the situation may be expected with the establishment of the Agency for International Development (AID). This

agency, under special circumstances, will offer more generous credit insurance terms to U.S. companies trading abroad.

Equally essential are devices to protect our investments in Latin America. Fidel Castro's expropriation of U.S. properties in Cuba has given investors the jitters. They fear that such take-overs may happen elsewhere. It is this fear, more than economic factors, which caused U.S. investments in Latin America last year to drop to one-sixth of what they were in 1957. Fortunately, we already have a nucleus of just and durable protective devices.

One such device is expressly provided for in the U.S. Mutual Defense Assistance Act of 1954. This Act, as now amended, allocates $500 million of foreign aid funds to protect U.S. investors abroad against expropriation and to guarantee their ability to convert their earnings to U.S. dollars. According to this provision, the U.S. government and the government of the Latin American country in which a *bona fide* and duly approved investment is made would share the responsibility of protecting that investment. Peru, Bolivia, Ecuador, Paraguay and Guatemala have offered to cooperate in providing such guarantees for U.S. investments in their countries. But under the Eisenhower Administration only about $20 million of U.S. investments were so insured.

EXPORT DEPENDENCE ON SINGLE COMMODITIES
(1957-59 average)

Country	Commodity	%*
Argentina	Meat	26
Bolivia	Tin	62
Brazil	Coffee	58
Chile	Copper	66
Colombia	Coffee	77
Costa Rica	Coffee	51
Cuba	Sugar	77
Dominican Republic	Sugar	48
Ecuador	Bananas	57
El Salvador	Coffee	72
Guatemala	Coffee	72
Haiti	Coffee	63
Honduras	Bananas	51
Mexico	Cotton	25
Nicaragua	Cotton	39
Panama	Bananas	69
Paraguay	Timber	24
Peru	Cotton	23
Uruguay	Wool	54
Venezuela	Petroleum	92

*Percentage of total export earnings derived from one commodity.

SOME OF the problems of U.S. economic relations with Latin America can perhaps be worked out through the common markets which are emerging in the area. In 1958 Columbia, Ecuador and Venezuela signed a common market agreement. Early in 1960 Brazil, Argentina, Chile, Mexico, Peru, Paraguay and Uruguay likewise agreed to form a common market area with duties and tariffs reduced or erased and all trade impediments minimized. Currently all the Central American states except Panama are planning another common market.

One Latin American nation alone rarely provides a really efficient market for a modern industry as most of them are too small. But by give-and-take easing of tariffs the nations can stimulate exports and imports and provide a better over-all balance of both.

Most Latin American business people urge the United States to join these common markets. This would demand reciprocal trade agreements between the United States and common market members to reduce or remove import duties. To sell many types of goods, it would often be necessary, at least temporarily, for U.S. firms to reduce prices and profits. But in the long run these firms would gain expanding markets.

Although there are still plenty of problems to be met, the travails of Latin America can be remedied. The recent Punta del Este Economic Conference has reaffirmed the fact that there is still a vast reservoir of friendship for the U.S. in Latin America. Many career students of inter-American relations regard the Punta del

Este Conference as the most significant Pan American gathering of the century. This meeting of economic ministers of sovereign American nations was a purposeful effort of the Kennedy Administration to present its "Alliance for Progress" program directly to appropriate officials of 19 Latin American countries. The assembled group was invited to hammer out, by means of a multilateral aid program, a durable hemispheric trade and development blueprint.

The Alliance for Progress is intended basically to be a program of social reform. But the delegates to the conference recognized that the establishment of cooperative inter-American trade relations must be a vital part of such a reform program. The conference specifically committed the Organization of American States to work toward the attainment of trade stability. It has directed the American Economic and Social Council to meet yearly to appraise and recommend specific trade plans for individual American nations. Each American nation has been given the opportunity to press ahead its own program of social reform under specific terms and conditions. At the same time, the way for much closer trade cooperation has begun on a regional basis.

However, even as the signers of our own Declaration of Independence headed homeward to face a crucial struggle in their respective states, so the delegates to Punta del Este had to realize that their job had just begun. The real battle lies ahead.

Even the attainment of an over-all *per capita* economic growth rate of 2.5 per cent annually over the next 10 years—a minimum goal to which the nations at Punta del Este commited themselves—will require great effort. Certainly the problem is being complicated by the population explosion. In 1900 there were 69 million people in all of Latin America; now there are 185 million. Population experts predict that in another 40 years there will be 500 million, if present trends continue. In rate of population expansion South America now leads all the continents.

In the face of these hard facts the U.S. pledge of $500 million toward the attainment of the Alliance for Progress program is subminimal. Practical financeers have estimated that annual investments of from $3 billion to $6 billion will be required if the Latin Americans are to reach the projected growth rate.

Another discouraging factor is the defeat of the Kennedy Administration's effort to put foreign aid on a long-term basis. If long-range development projects are to achieve their maximum effectiveness, they cannot be dependent on an annual Congressional appropriation. The unhappy truth is that the functional basis of our entire aid program remains as before—short term, inadequate and unstable.

What, then, is the future for Latin America? The hopeful factor is that at Punta del Este the assembled nations pledged their faith in free enterprise as the means of improving their standard of living. It is up to us to show our neighbors that we are sincere in our efforts to help them in their struggle. Our aid program must become practical and meaningful. We must constantly work at reducing trade barriers; and we must encourage the kind of private investment in Latin America that will plow money back into the economics of the area rather than exploit its resources for private profit. It is in our power to find the means for achieving these ends. We cannot afford to fail. ■

Counteracting the business cycle

Public Works and Postwar Recessions

by WILFRED LEWIS, JR.

► *Each of the four postwar recessions has generated widespread discussion of the efficacy of public works as a countercyclical device.* WILFRED LEWIS, JR., *a staff member of the Bureau of the Budget, is on leave of absence to examine the problem of fiscal policy during recessions for the Brookings Institution. He believes that public works programs, as presently constituted, hold little promise as antirecession devices for political as well as economic reasons.*

HOWEVER HAIR-RAISING it may have once seemed to pursue a deliberate policy of budgetary deficits during recessions, this idea is now commonly accepted. Although politicians are not as enthusiastic about such pump priming as economists, even *they* accept deficits as a necessary evil.

This attitude marks a change of revolutionary dimensions from the prevailing attitude during the depression-year election of 1932. Then both the Democratic and Republican candidates agreed that the first order of business in restoring the economy to a sound basis was to raise taxes and balance the budget. President Roosevelt's subsequent attempts to do this proved, of course, to be self-defeating.

Today we have reached the point where debate over counterrecession policy need not bog down on the question of whether there should be a deficit; it can concentrate on more pertinent questions such as

how and for what the deficit should be incurred.

The first order of business in fighting any recession is to get people back to work. Since the beginning of the Great Depression the most frequent answer to the problem—advanced by politicians and laymen, as well as professional economists—has been "public works."

The popularity of public works spending as a pump priming device is not hard to understand. It would obviously be inefficient to try to step up many ordinary government activities—say, internal revenue audits, or patent investigations or customs inspections—to offset trends in the level of private employment. But a few years more or less spent in constructing an office building, or a dam or a highway which will have a useful life of 50 to 100 years seems not only harmless but useful.

What use was actually made of public works spending during the four periods of high unemployment since World War II? Could it have been used more effectively?

THE FIRST postwar recession began in October, 1948. The Truman Administration's reaction, however, came rather slowly. Not only did the recession go unmentioned in the annual Presidential messages the following January, but the messages diagnosed the economy's principal problem as being inflation. As a cure, the Administration prescribed direct price and wage controls.

Congress fortunately ignored these requests, but generated little pressure of its own for countercyclical measures. Gross national product reached a low point in the second quarter of 1949, two and one-half per cent below the previous peak in the last quarter of 1948. The decline was cushioned by the inherent stamina of the economy and by the built-in stabilizers (the automatic increase in unemployment benefits and decrease in income tax collections touched off by the recession). The recession's impact was also softened by the effects of a major tax cut enacted the previous year. Because of its retroactive features, this tax cut gave rise to unusually large refunds in the spring of 1949.

Production moved sideways for the next two quarters, and unemployment reached a peak rate of eight per cent of the labor force in October, 1949. While there was some concern in business and academic quarters, the official attitude in Washington, once it was realized that inflation had in fact ceased, was that no more than a temporary respite was taking place and a little "disinflation" after the sharp postwar price rises of 1946 and 1948 would do no harm.

The sharp recovery in the first half of 1950 was sparked by renewed private demands for housing and automobiles, and received no stimulus from public works or other deliberate countercyclical actions. By mid-1950, when the Korean war turned attention from lingering unemployment to the renewed threat of inflation, the recovery was substantially completed.

The end of the Korean war in 1953 coincided with the efforts of the newly installed Eisenhower Ad-

ministration to stretch out defense procurement and cut back nondefense spending. The resulting drop in government orders and expenditures, which continued to decline until well into 1954, was a major factor in the recession which began in the second half of 1953. Although of longer duration, this recession was slightly shallower than its predecessor.

On January 1, 1954 individual income tax rates dropped back about 10 per cent, as scheduled under the 1951 Korean war revenue act, and the excess profits tax was finally allowed to die. The stimulus these gave the economy was offset in part by an increase in social security payroll tax rates, which began on the same date. A little later, Congress cut some of the excise rates instituted during the Korean war and, in August, the Revenue Code of 1954 was enacted. This latter was aimed primarily at improving the tax system from the standpoint of equity and long-term economic growth, but, incidentally, it reduced tax revenues. It would be inaccurate to describe these various tax reductions as deliberate counterrecession actions, although their occurrence reduced the need for other action.

The low point in the recession was reached in the second quarter of 1954, when the gross national product was three per cent below the peak of a year earlier. Starting in mid-1953 there had been several attempts to coordinate and classify public works so that a "shelf" of useful federal projects would be ready to start on short notice if needed. But these were not used during the recession and, in fact, it is doubtful if the shelf actually existed except in name. Later, in 1954, the Congress enacted a program of loans to localities for the advance planning of public works projects. But, few such loans were made by the middle of 1955, when recovery was substantially complete, and the program was never used for counterrecession purposes.

ASIDE FROM the tax cuts described above, which probably would have taken place anyway, the major discretionary action to fight the recession was an attempt to reschedule fiscal 1955 expenditures as early in the year as possible without affecting the total budget. Although a number of programs were affected by this move—such as defense, lead and zinc stockpiling, and shipbuilding subsidies—the public works totals involved were quite small.

In the recession of 1957-58 discretionary expenditure increases, including public works, were used more freely than they had been in the two previous postwar downturns. The recession advanced more rapidly and resulted in higher levels of unemployment than either of the others. Recovery after the April, 1958 low point was also more rapid than in 1949 or 1954, giving rise to the description of 1957-58 as the "plunging neckline" recession. Although the January, 1958 Economic Report hinted at continued recession, the budget stressed restraint in expenditures in general and a policy of no new public works starts in

particular. The Administration's attitude, once the recession was acknowledged, was that corrective fiscal policy would probably not be required, but if it were, it should be in the nature of tax cuts rather than "make-work" expenditures.

However, a number of steps were taken with and without Congressional action, all on the expenditure side. A temporary 50 per cent extension of eligibility periods for unemployment benefits was enacted. The Federal National Mortgage Association was given $1 billion to purchase GI mortgages on new low-cost houses. Civilian agencies of the government were directed to speed procurement of supplies and equipment, and were given blanket authority to purchase up to half of anticipated fiscal 1959 supplies and equipment in advance of specific appropriations. Loan criteria were relaxed in certain federal credit programs. States, localities and private parties were asked to speed action under various programs supported by federal grants or loans.

In the public works field, a general policy of speeding up work on approved civil projects for which funds were available was ordered by the President in March, 1958. Supplemental appropriations for 1959 were requested to enable the speed-up to continue into that year. Congress passed a resolution asking that military construction be similarly accelerated. A Post Office modernization program was announced. Regular highway grants were increased, and a special $400 million authorization was passed for grants to states for additional highway work that could be started quickly.

A program of federal loans for construction of local public works again received strong support in Congress as an antirecession move; but it failed to pass. A multibillion-dollar river and harbor authorization bill was passed with some claims that it would stimulate employment, but it had no significance as a counterrecession measure because of the long lead-times involved in starting new projects in the water resource field.

Of the various public works actions, the highway program was the most important, although there is no way to tell for sure to what extent the increased federal grants substituted for, rather than added to, state-financed highway outlays that would have taken place anyway. The fact that federal loans were made available for part of the state share of the cost helped keep this "substitution" effect to a minimum, since the states are ordinarily hard put to raise matching funds on short notice. The speed-up of construction of other civilian projects added something over $100 million, perhaps as much as $200 million, to federal outlays during the recovery stage. There is no evidence in end-of-year budget figures that a speed-up in military construction in fact took place. The Post Office modernization program got started about in time for the next recession; only minor amounts of contracts had been let by June, 1960.

THERE IS little doubt that the discretionary actions helped recovery, but public works were only part of the story. Temporary extended unemployment compensation was probably as important as the various public works actions combined, and the total of discretionary actions was less important than expenditure increases—pay raises, farm price supports and defense outlays—which occurred for reasons unrelated to the recession. The fact that the Highway Trust Fund soon ran out of funds, which was expected when the speed-up started, guaranteed reversibility to a program that would otherwise have been hard to turn off. Gas taxes were increased in the fall of 1959 and highway grant authorizations were cut back sharply. Although the states were not overly joyful about this off-again, on-again behavior of the federal government, this would have been one of the more successful postwar attempts to institute a major public works program to counteract both recession and inflation—except for one minor detail. The recovery from the 1958 recession never reached entirely satisfactory levels, and the highway reversal in 1959-60 contributed to the next recession.

The 1960-61 recession differed from earlier ones in a number of ways. To start with, unemployment was significantly higher at the second quarter 1960 peak than at the start of the other recessions. In fact, it is fair to state that the economy never fully recovered from the 1958 recession before the next one started. Also some key demand components, such as housing and producer's capital investment, appeared distinctly more sluggish than before. On the other hand, the decline in over-all production was slower and, at the trough in the first quarter of 1961, had fallen less than in any of the three previous recessions.

As before, counterrecession actions were confined to the expenditure side of the budget. The Kennedy Administration made no secret of its belief that both defense and nondefense federal spending had been unduly restricted before it took office. Moreover, since the size of the gap promised a long period before full employment would be approached, it was argued that slow-starting programs with long lead-times could safely be initiated without fear that their later expenditures would come at a time of inflationary pressures. Thus, in the spurt of activity that started in February, proposals to counter the recession as soon as possible by means of expenditure increases were made at the same time as proposals to expand programs for longer range goals.

TEMPORARY extended unemployment compensation along the lines of the 1958 program, aid to children of the unemployed, extra GI insurance dividends and a general speed-up of procurement and construction under existing programs—these were primarily antirecession in nature. Not primarily related to the recession were proposals for stepped-up authorizations for health and welfare programs, urban renewal, defense, space, college housing, public facility loans, aid to education and medical care for the aged. Other proposals, reflecting a mixture of antirecession and long-range goals, were liberalization of social security benefits to be offset later by higher payroll tax rates, increased farm price supports, an expansion of the school lunch and surplus food disposal programs, "cost of living" increases in veteran's compensation benefit rates, and new programs for retraining and relocating the unemployed, and for grants and loans to depressed areas.

Rising defense and other federal outlays were a big factor in the sharp rise in the economy starting in the second quarter. But so far, at least,

the role of public works in the recovery has been minor. As in previous recessions, a major program of federal loans for local public works received strong support in Congress but was not enacted. The Administration catalogued and considered a broad expansion of federal public works involving additional new starts, but has so far relied on speeding up projects already under way or already scheduled for starting. There is little evidence that the speed-up ordered in February has had much effect in the public works field. Public construction put in place through July had fluctuated some but in total moved mainly sideways, and outlays for several of the larger public works programs, such as the Bureau of Reclamation, Tennessee Valley Authority and highway construction, wound up the fiscal year even with or below the January estimates of the outgoing Eisenhower Administration.

IN SUMMARY, while discretionary antirecession actions helped spur activity during three of the four postwar recoveries, significantly so in two of these, the role of public works, with the possible exception of highways during the 1958-59 recovery, has been modest. Moreover, deliberate counterrecession actions in total have been less important than expenditure increases (or tax cuts) undertaken for other reasons. Whether the government should have taken more vigorous steps to promote recovery has been argued both ways. But for a number of reasons there is evidence that a greater attempt to use public works would not have substantially hastened any of the postwar recoveries.

Planning public works projects of any size requires a considerable period of time. There must be surveys of the land, engineering studies, a calculation of costs and benefits, Congressional authorization of specific projects, postauthorization planning in more specific terms and then Congressional appropriation of necessary funds. Depending on the size and type of project, these steps may require several years.

Not all federal public works, however, are large and inflexible. Flexibility exists for small projects not involving elaborate planning or the acquisition of new land. There is also some flexibility in the form of deferred maintenance and repair, modernization and rehabilitation of existing structures. The total size of such programs, however, is in the tens of millions of dollars, so that a considerable expansion of them would provide only a modest impact on the economy.

Speeding up the rate of work on going projects is a better means of achieving flexibility. Flexibility on going water-resource projects is to some extent limited by the practice of appropriating funds on a year-to-year basis even for multiyear projects, and also by the fact that, once contracts are let, the rate of progress depends essentially on the contractor's initiative. However, if going programs are being held down for budgetary reasons, if there are appropriated funds held in reserve, or if approved and funded new starts are being delayed to minimize the first-year cost, flexibility can be achieved by removing restraints, releasing reserves or moving up the scheduled starting dates.

STATE-LOCAL public works aided by federal grants face similar obstacles, and a few more besides. States or localities have to raise matching funds for grant programs—which may be difficult in recession years. Projects have to be reviewed not only by local authorities but also by the administering federal agency. And it may be difficult to prevent federal grants in the short run from simply replacing rather than adding to construction that would be undertaken with state or local funds anyway.

For these and similar reasons, public works provide only slight potential for releasing spending power on short notice. That potential could be increased if a shelf of fully planned projects were made ready, with money already earmarked, so that they could be started quickly.

There are, on paper, two major shelves of planned projects, but it is easy to exaggerate their importance. In January, 1961 the reserve of authorized federal projects, aside from projects scheduled for starting by the end of fiscal 1962, came to $12 billion, of which $7 billion had plans in process, $4 billion had had no planning and $1 billion was "planned to the stage where contract could be let." By the end of fiscal 1962 an additional $1.5 billion was expected to be fully planned.

However, "planned to stage where contract could be let" does not in fact mean that construction is ready to start. While Congress has granted "authorizations," it has not yet appropriated the money in most cases. Besides that, there is the drawing up of contract specifications, advertising for bids, and then a further wait while bids are opened and a contractor specified. More important, the necessary land has usually not been acquired—this sometimes requires lengthy condemnation proceedings—nor have agreements been worked out with localities on cost sharing. Furthermore, the great bulk of the shelved plans are for large water resource projects—which do not reach peak construction rates for several years.

Under a program initiated in 1954, the Community Facilities Administration has built up a reserve of $3 billion of planned nonfederal projects. However, only a few of

these projects qualify for federal assistance during actual construction, and most of the projects have had only the most preliminary planning.

Not only are public works projects slow to start, but, once started, construction may be carried to a stage where it would be difficult or inefficient to try to slow down or stretch out work. This "irreversibility" has probably inhibited more ambitious attempts to use public works in recessions, but its importance has probably been exaggerated. Postwar recessions have been short-lived, but the economy has not always returned to full employment. More important, in an expanding economy in which both public and private outlays may be expected to grow, reversibility need not take the form of an actual decline in construction already begun. It may be sufficient merely to slow the rate at which other new projects are started. This is much easier said than done, but the difficulties are political rather than mechanical.

The successful use of public works to counter recessions requires a shelf of approved, planned projects ready to start, and such a shelf requires either a slowing down once the recession is over, or at least the ability to stop short of actually constructing useful public works that have been fully planned. As a practical matter, planning is generally carried to advanced stages only for projects deemed to have considerable intrinsic merit. For such projects, the fact that the economy happens to be operating at full employment seems to many—certainly to the locality most directly involved and its political spokesmen—an insufficient excuse for delaying construction.

This requirement of a flexible fiscal policy which can work one way during recession and another during full employment rules out several significant categories of public works as potential sources of counterrecession action. Few would argue, for example, that planned, useful missile bases or urban renewal projects ready to start should be delayed because of full employment. Yet, without such restraint, there can hardly be a backlog of projects available for starting in recession periods.

If public works as presently conducted hold little promise of more effective counterrecession impact, what are the alternatives? One possibility is to let well enough alone. Considerable progress has been made since the early Thirties, when reducing expenditures or increasing taxes was considered the appropriate way to restore an economy to soundness. Built-in private, fiscal and monetary stabilizers provide a strong line of defense against a deep depression. In fact, they have, so far, been strong enough to give a strong bounce to the economy after each postwar recession.

But built-in stabilizers provide no guarantee of return to full employment unless and until the original causes of a recession are removed. Moreover, there appear to be few promising means of further strengthening these stabilizers. Spending programs other than public works have been imaginative and helpful, but they also have definite limitations.

Perhaps the major untried alternative to public works outlays is that of reducing tax rates. Tax cuts hold greater potential for countering recession than public works spending in the sense that the federal budget includes upwards of $80 billion of revenues compared to only $7 billion or so of public works construction. But, otherwise, tax cuts have no inherently greater flexibility than public works. Tax cuts, too, would be hard to initiate after a recession started and hard to reverse later.

It is very difficult politically to unravel the pros and cons of which taxes should be cut in time to counteract a recession already begun. As with public works, the "shelf" would have to be constructed beforehand; that is, political agreement would have to be reached on the type and size of tax reduction that would be made under recession conditions, and fairly automatic procedures set up for implementing it. The idea of giving the President stand-by power to take discretionary tax action has received renewed support since the CED Monetary Commission recently recommended such a step. It remains to be seen whether Congress will delegate a portion of its powers in this important field.

We have come far since the 1930s in public action to offset unemployment. Further progress may be more difficult. ■

The powers of the states

WHO SHOULD TAX INTERSTATE COMMERCE?

by HAROLD M. GROVES

► *Congress has recently authorized the House Judiciary Committee to make a full-scale study of one of the oldest and most perplexing problems of American federalism—state taxation of interstate commerce. Confusion among the tax laws of the various states in this area has been a headache to business and may be costly in terms of its effect on our free market, the allocation of our resources and economic growth.* Prof. Harold M. Groves, *of the University of Wisconsin, has been appointed to the advisory group assisting the study. Here he examines the issues involved and points out the possible implications for the economy as a whole.*

When the state governments try to tax entities that are not entirely within their jurisdiction—that is, enterprises engaged in interstate commerce—they are due for a lot of trouble. This is one reason why authorities on taxation have, in the past, felt it unwise for states to venture into the income tax field.

Notwithstanding this advice, some two-thirds of the states now collect income taxes. And they have not

hesitated to apply their statutes to businesses that buy, manufacture and sell across state boundary lines. They have taxed these companies on the basis of "reasonable apportionment"—i.e., the percentage of business carried on within a state's boundaries. And they have relied mainly on the courts for jurisdictional guidelines on when a state has any reason to tax a business at all.

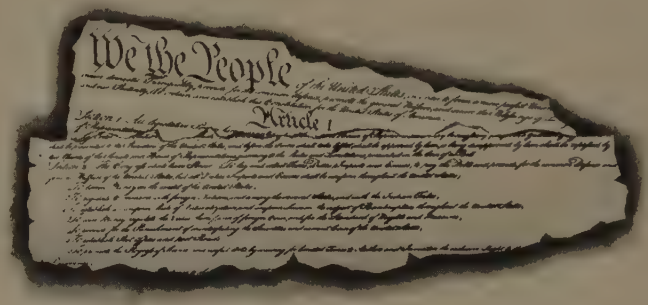
The mounting current interest in the conflict of state tax laws governing interstate commerce stems directly from certain decisions of the United States Supreme Court. These decisions uphold the right of a state to apply an apportioned income tax to corporations having no tie with the state other than a sales office. Indeed the Court has indicated that sales solicitation alone is sufficient basis for taxation.

Going beyond even this, the Court held, in reviewing a Florida case, that Florida could collect a use tax from a corporation which had no office or regular employees located in the state, and whose only tie with Florida was with wholesalers who solicited orders for them. These wholesalers were paid a commission and served several companies. The fact that they were not regular employees of the corporation was considered by the Court to be a fine distinction without significance.

DISSENTING from the majority view in all but the Florida case, Justice Frankfurter observed that the decisions "broke new ground" and that no precedent could be cited where the Court had previously allowed a tax on "exclusively interstate commerce." He expressed concern about the compliance costs that the decisions might involve: "The cost of such a far-flung scheme for complying with the taxing requirements of the different states may well exceed the burden of the taxes themselves." Most significantly he made a strong plea for Congressional action: "Congress alone can formulate policies founded on economic realities, perhaps to be applied . . . by a properly constituted and duly informed administrative agency." This open bid to Congress was seconded by the majority opinion.

The law which Congress recently enacted in response to this plea provided that, for an interim period, no state could tax a company unless it had an office in the state and approved orders within the state. The law also prohibited a state from taxing companies who solicited and filled orders within the state solely by means of independent contractors serving more than one company.

These specifications were not intended to be final; the law called



for a study by the Judiciary Committee of the House and the Finance Committee of the Senate to determine what further legislation is required. These Committees were instructed to recommend to Congress legislation providing uniform standards to be observed by the states in imposing taxes on income from interstate earnings. The mandate has since been broadened to include all taxes on interstate commerce and the Senate Committee has decided to defer to the House project.

THE IMMEDIATE issue before the subcommittee appointed to study the problem is that of *jurisdiction*. Under what circumstances, if any, should the states be precluded from taxing interstate business and from requiring firms that are in some sense operating within their borders to file reports with them? But this issue overlaps and leads into the one of *apportionment*. How much of a firm's income (or other tax base) should any state be allowed to claim? It will be convenient here to consider the latter question first.

First, it should be said that uniformity is a prime goal in any overall plan of apportionment. If all states used the same formula, with factors commonly defined and definitions commonly interpreted, the total income taxable by all states could not exceed 100 per cent, nor would it fall short of 100 per cent. Unfortunately, states use different formulas and interpret them differently, which means there are gaps and excesses in the over-all account. It is probably true for the long-run welfare of states as well as business that almost any uniform apportionment is better than a haphazard, state-by-state arrangement.

Nevertheless, there are issues involved in the choice and weight of apportionment factors that can stir quite intense controversy. The most commonly used formula is one that gives equal weight to tangible property, payroll and sales. Thus, if a business has 50 per cent of its tangible property, 40 per cent of its payrolls and 60 per cent of its sales in a given state, the business tax base for the firm in that state would average out at 50 per cent of its net income.

The principal controversy centers upon the definition of "sales." One view is that sales should be credited to the state from which shipment is made, or to the state in which the contract of sale is accepted, or to the state where the headquarters of the salesmen making the sales are located. The other view is that sales should follow the destination of the goods regardless of where the sale contract is made.

IN DEFENSE of the first position it is argued that the location of the market is irrelevant in considering where income is created; goods are produced *for* consumption and not *by* it. If a state wishes to tax consumption rather than production, it

should do so by the imposition of a sales tax. By collecting taxes on a market basis, a state is, essentially, importing a tax base from somewhere else with the result that the market states profit at the expense of the manufacturing states.

Proponents of the second view argue that the market is as essential as any other factor in the creation of income. More revelant, perhaps, is the allegation that production *requires* sales activity and that there is no essential difference between sending in a salesman, on the one hand, or soliciting by telephone, mail or other advertising media, on the other. Moreover, it is said that the sales factor makes no sense at all unless it be associated with destination since property and payroll (which are involved actively with selling) are already taxed in the "home state" of a business. As for importation of tax base, no state can buy if it does not sell, and the advantages and disadvantages in terms of revenue are difficult to establish. And even if the market states stand to gain—well, they are the poorer states to begin with and therefore *should* gain.

TURNING to the jurisdictional problem, we may say, first of all, that it has now been established that a state *can* tax interstate commerce. It is also generally agreed that interstate commerce should be taxed. The problem is one of determining the circumstances under which a state can—and cannot—exercise its right to tax such commerce.

The problem of jurisdiction also exists with regard to franchise or privilege taxes—state taxes levied on a corporation's "privilege" to operate as a corporation. But there is a curious anomaly here. It appears settled that states cannot apply such taxes against foreign corporations exclusively engaged in interstate commerce. Congress might be well advised to remind the Court that the difference between an income tax and a privilege tax measured by net income is one of form and not of substance. But there is an enormous amount of law and some vested interests at stake in the matter.

In terms of strict logic, the questions of jurisdiction and apportionment are intimately related. In other words, if the destination of goods is the relevant factor in one case, it should be relevant in the other. On the practical and administrative side, it can be argued that the location of the market is a simple idea, easy to define and not subject to manipulation. But it is here we confront the crucial economic issue of compliance cost. It is alleged that wide-open jurisdiction to tax would balkanize the United States, ruin our free market, and seriously affect our allocation of resources and our economic growth.

Before discussing this important issue more fully, we should recognize that proponents of a market test of jurisdiction and allocation advocate a quantitative limitation on taxability. They say that a state should not be allowed to tax incidental sales made within its borders. Otherwise a corner haberdasher could incur tax liability in another state by selling and delivering an overcoat to an out-of-state purchaser. Such a limit could also be applied, of course, to the other test of jurisdiction (that of the place of sales activity). In other words, a firm would have to work a specified number of salesman-days per annum within a state before it could be taxed by that state. No doubt setting a quantitative standard of any kind would involve difficulties of its own.

As previously suggested, the determining factor in limiting jurisdiction by legislative action will undoubtedly be the consideration of compliance costs. Unfortunately, we know very little about them. This is an area in which a great deal more research is needed.

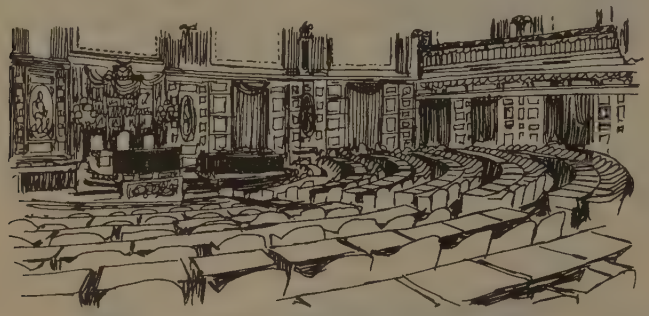
Of some significance, too, is the fact that compliance costs might differ according to the size of an organization. It is alleged that under wide-open rules of jurisdiction small business would surely be at a disadvantage. "The little fellow can't afford a bookkeeper." However, the type of firm that would be hardest hit, it seems, would be the one with a thin volume in many states.

It is important to know wherein the major compliance costs lie. The major problem for a company would probably not be in figuring out how its business was apportioned among the different states. The chief concern would be to maintain familiarity with diverse state laws. No doubt compliance costs would not be prohibitive if all one had to do were to submit a duplicate of his federal income tax return along with uniform apportionment data. Furthermore, compliance costs might be reduced, not only by limiting jurisdiction, but also by working toward a more uniform definition of corporate income. A federal agency created to function in this field could probably accomplish a great deal in urging the states toward uniformity, though it might not be able to *compel* them.

A SOMEWHAT fragmentary but pioneering study of the effect of different bases of jurisdiction was presented by Paul Studenski and Gerald Glasser, New York University economists, in a 1958 issue of *Harvard Business Review*. Their study concentrated especially on 25 companies, most of which were large. On what the authors call the traditional basis of jurisdiction (presumably where there is an office from which shipments are made), only five of the 25 companies would be taxable in more

than five states; the number jumps to nine when sales office is the criterion; and to 22 and 24 if resident and nonresident salesmen are the basis. Typically, the firms sold products in two-thirds of the states. The authors attempted no systematic study of compliance costs. But they offered testimony of several accountants who said that the preparation of a state tax return typically requires an outlay of $100 to $200 and that this is not infrequently more than the tax involved.

If the states stand to gain a considerable amount of tax revenues by being allowed to widen the tax basis of companies engaged in interstate commerce within their borders, the heavy compliance costs of those companies might be considered a necessary evil. If, however, the revenue at stake is negligible anyway, and wide jurisdiction only constitutes a nuisance to business, it would seem sensible to limit the states' range of jurisdiction. If this means sacrificing logic for convenience, so be it.



The above exposition does not begin to indicate the formidable detail that any comprehensive study of the taxation of interstate commerce would involve. First, there is the necessity of further defining each of the factors in an apportionment formula. Also, there is the problem of determining what part of a company's income has nothing to do with its interstate business at all and thus should not be apportioned as a tax base among the different states. The income from some real estate and some intangibles, for example, would normally not be apportioned. Certain interest and dividends are usually taxed in the state which is said to be the "domicile" of the firm —but the word "domicile" may be defined in several different ways.

It is generally conceded that a three-factor formula, with equal weight given to the factors of property, payroll and sales, will not suit all circumstances; thus, someone should have the administrative power to modify the application of the formula as necessary. Where should this power be lodged? It is recognized, too, that railroads, airlines, truck carriers, communications, financial companies, etc., would present special problems which would have to be considered in any formula of apportionment. And what about privilege taxes? Should they be covered by the same rules of apportionment and jurisdiction as corporation income taxes? Certainly an effort should be made to clear up the uncertainties and ambiguities that confront business in this area.

All of these problems have to do with taxing *income*. There are similar difficulties associated with a dozen other levies connected directly or indirectly with interstate commerce. Among them are the sales tax, capital stock tax, property tax and motor vehicle license tax. Then there is the field of personal income taxes. After all, there are persons, as well as businesses, whose income is divided among several states.

Congress may be in a mood to settle for minimum legislation that will go no further than to insure that interstate commerce will not be unduly burdened with compliance problems. Or it may be ready to undertake the preparation of rules of the game to cover the entire field of conflict among state tax laws. If the legislators decide to stop with the first alternative, their task will be relatively light and the implementation of their recommendations relatively simple. But if they begin work on the second alternative, the problem of implementation will become formidable.

Rules will require interpretation—i.e., regulations—and they will have to be flexible. A great deal of research will be required; no committee is going to cover this vast field before 1962 and, thereafter, continual review may be in order. Perhaps the first order of business may be some action—partly administrative, partly judicial—on appeals now pending. This adds up to action along the lines of Justice Frankfurter's suggestion—the creation of a new standing federal agency in the field. Such an agency would, no doubt, be located in the Department of Commerce.

Any ambitious program entertained by Congress in the field we have been discussing is sure to be attacked as federal invasion of the province of the states. But does it not seem logical that the conflict in state tax laws should be one of the first orders of business for the federal government in a federal system? In the long run such action may protect states' rights rather than curtail them. The states should, of course, be given every opportunity to express their views. There should be "no dictation without representation." And if a federal agency is created, it would be ideal if the states could be allowed to nominate a member of the new board.

The federal Constitution says nothing about the conflict of state tax laws and its application to interstate commerce. But the Constitution gives Congress the power to *regulate* interstate commerce. Thus, although Congressional power in this area is indirectly derived, there is no doubt that Congress could do the job. How far it should go is another question.

That there is a lot of confusion and discrimination in the application of state tax laws to business extending beyond state boundaries is evident enough. How costly this situation is in terms of tax equity and economic growth we don't know. But the price may be considerable. At any rate, in attempting to untangle the complexities of the problem, Congress now has the opportunity to lay a solid plank in a sound structure of U.S. federalism. ■

Federal Tax Reform

by DAN THROOP SMITH

►*Although most people who have studied the workings of our tax system will agree that it is badly in need of large-scale reform, there is no general consensus on what such an overhauling should entail.* DAN THROOP SMITH, *Professor of Finance at the Harvard Graduate School of Business Administration and former Deputy (for tax policy) to the Secretary of the Treasury, puts the problem in perspective in his recent book. Reprinted by permission from* Federal Tax Reform: The Issues and A Program *by Dan Throop Smith. Copyright 1961. McGraw-Hill Book Company Inc.*

TAXES ARE compulsory payments which individual citizens make, directly and indirectly, for services provided by the government. Each citizen will have his own doubts and reservations about what he regards as the excesses or deficiencies of government programs and the spending thereon and about the distribution of the burden of the taxes which pay for them. But for better or worse, the existing program of expenditures and taxes at any time represents the consensus of national opinion as it is resolved, perhaps inadequately, through the entire process of government.

Taxes, by themselves, are generally bad because they tend to discourage economic activity and investment. They also divert attention away from productive effort to maneuvers to save on taxes rather than to acquire income. At a 90 per cent income tax rate, it is as useful to an individual to save $1,000 in taxes as to make $10,000 of income.

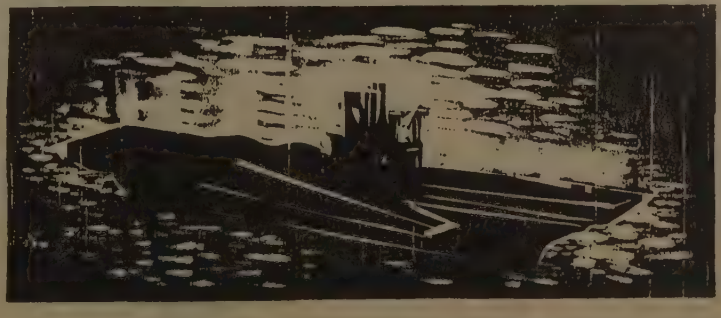
High taxes also lead to complicated tax laws. High tax rates make Congress particularly susceptible to pleas for special relief by groups of people or industries, and relief provisions are inevitably complicated. Other complicating provisions are necessary to close loopholes, which often arise even within special relief provisions.

Complicated laws increase taxpayers' annoyance. And special relief provisions, though welcome to those who benefit from them, are likely to make those who do not get special treatment still more resentful of the additional tax burdens which they must carry. Ultimately, resentment can rise to the point where taxpayer morale breaks down.

We still have in this country a tradition among most people that tax fraud is morally reprehensible. But this attitude is strained by high taxes, especially if there is doubt as to the fairness of the distribution of the burden. If we ever reach a stage where outright tax fraud is socially acceptable, public corruption of other sorts will be condoned and our form of government will be truly in danger. The fact that a conviction for tax fraud does not prevent election to public office is disheartening and a frightening sign of deteriorating tax morality. Tax reform is needed to prevent further deterioration.

Taxation is the method by which we pay for government activities, which are presumptively good. Private incomes are diverted from private consumption to joint or public consumption. The good effects of wise government expenditures should more than offset the bad effects of the taxation which pays for the outlays. Thus, though taxes are bad by themselves, they become acceptable as the only available way of financing the basic governmental process which is necessary and the supplemental government services which may be very good. But the higher the general level of taxes, the greater the chance that the inherent bad effects of taxation may outweigh the advantages of the government expenditures which they finance.

It has sometimes been said that there is some universal point at which any tax system breaks down. Taxation at some such figure as 25 per cent of the national income has been mentioned as the bearable limit. There is a further implication that tax burdens below this point can be imposed without concern. Neither the general proposition nor the implication is correct. A bad tax system can produce great damage even though the total tax burden is not great, while a wisely designed tax system can support a high level of government expenditures without significant damage. The greater the total tax burden, the more important it is that the tax structure be critically reviewed to keep its inequities, its repressive effects, and its complexities at a minimum and the more impor-



tant it is that expenditure programs be really justified.

The tax burden in this country is heavy. Our tax structure in many respects is bad. The possibility of serious and lasting damage to public morale and to prospective economic growth is real. In this book, on the regretful assumption that we shall continue to have high taxes, various suggestions are made as to how the tax laws can be made fairer, less repressive and simpler—in brief, more bearable. Only with tax reform can we expect to continue to carry the tax load which is the price we must pay for survival in this time of peril and for public improvement in this time of opportunity. . . .

ADEQUATE DEFENSE expenditures are basic for the very existence of a society; government defense expenditures are necessary for survival. So are nondefense expenditures for certain basic functions, such as those for police, the judiciary and general government. These are essential for the existence of a complex society. Other government expenditures such as those for education, public health, a system of highways and the conservation of natural resources, if made wisely, can greatly increase the base for private production activities and the national income. And still other government expenditures can also provide a better basis for the "good life"—outlays such as those on the cultural aspects of education, aesthetically pleasing public buildings, national parks and municipal cleanliness are forms of consumption which can be provided more effectively, and in some instances exclusively, by governmental action. They are features of our life and community which we would be sorry to forego. As we become more prosperous individually and as a nation, we can reasonably afford more of the amenities provided publicly as well as more of our privately purchased luxuries. But this does not mean that all government expenditures are good.

Many critics in our society advocate new and ever-larger government functions and outlays as the cure for most problems. Such undiscriminating advocacy of spending is irresponsible in ignoring the damage which is likely to be inflicted by ever-higher taxes required to pay for the enlarged scope of government activity. And it is fundamentally wrong in the assumption that larger government expenditures automatically make a better society. In fact, public expenditures seem as likely to be made extravagantly as are private expenditures, especially when they are not directly related to the taxes which must be imposed to support them. Public extravagance can undermine a society and the individuals of which it is composed in the same way that private extravagance can undermine a single individual or family.

The gross inadequacies of our education system, for example, appear to arise more from wrong standards and objectives than from inadequate funds. The use of taxes to pay for "life adjustment" courses in schools

seems as silly as private spending on items of conspicuous consumption. Such a use of taxes is a good deal more harmful to our society, since it diverts time from real education and creates an undesirable standard of conformity at the expense of individuality and differences in personal achievement. Nor is public spending necessarily the solution for bad housing. Attractive public housing is quickly turned into a slum by slovenly occupants, while individually responsible citizens with decent standards will make good homes in inferior buildings.

MORE FUNDAMENTALLY, increasing reliance on government programs is likely to sap individual initiative and responsibility. The presumption that government action represents an idealized joint effort for mutually desired objectives is too often a naive misconception. A religious community or a neighborhood group may do things collectively with a reasonable chance to balance efforts against results, but large-scale representative government is subject to pressures which lead to results different from those which would be achieved in a small group where both effort and results can be appraised simultaneously.

Public assistance can degenerate into handouts and even rackets, protected by the anonymity of the recipients and their families who in many cases should be responsible for those who are actually in need. If not adequately supervised, it can attract to a community people who are at best parasitic. The belief that society owes everyone protection even against his own misdeeds and negligence contributes to the sort of softness and personal irresponsibility which is the cause of so much concern to those who recall the pattern of degeneration of other civilizations.

It is not appropriate in this book on taxation to review the specific expenditure programs which make the taxes necessary. Every citizen has his own individual judgment as to which ones are handled extravagantly and which ones stingily. The government has in it at one extreme men obsessed with increasing their own status by enlarging the scope of the activities under them regardless of their value (the so-called empire builders) and at the other extreme dedicated men who are frustrated by inadequate funds. Publications of trivial value and rivalries among agencies with duplication of efforts and unnecessarily large staffs arise from the former. Ridiculously small expense allowances for our representatives abroad and inadequate funds for tax collection—larger appropriations would pay for themselves several times over and give greater public confidence that the laws are being applied fairly—are examples of the latter.

Those who criticize waste in government should examine their own attitudes concerning proposed reductions which affect their own group or locality; the almost universal objections to closing an unnecessary government facility or office dishearten the people in government who are

concerned with efficiency and economy. Sometimes it seems that there is political realism in the facetious remark, "We must reduce expenditures drastically, but we must be careful not to affect anyone's constituents."

In the traditional New England town meeting, with everyone voting on all major items in the budget and aware of what each $10,000 of town expenditures means in terms of his own taxes on his home, there is a fair chance that the allocation between private and public expenditures will be rational or at least will represent a consensus of opinion. But as the decisions concerning government expenditures move further and further away from the people concerned, and as the connection between expenditures and taxes becomes more and more tenuous, the chance for rational decisions or even a true consensus of opinion becomes less likely. The arguments, logical and emotional, for particular expenditure programs are appealing, and strong pressure groups build up around them. The balanced judgments present in a town meeting because everyone knows that an expenditure means a specific, identifiable and immediate personal tax burden are hard to attain in larger scale governments. In our national government, different Congressional committees deal with appropriations and taxes. There is a multiplicity of taxes with no identifiable relation between specific taxes and specific expenditures. And, unhappily, at times there may not be any real concern about balancing the budget anyway. Unofficial comments of municipal officials to state officials and of state officials to federal officials testify to the decreasing discrimination with which programs are appraised as they reach higher levels of government and become more remote from the people. Thoughtful proposals to improve the processes of budget review and control in both the legislative and executive branches . . . have been made. . . .

In striking a balance between the bad effects of taxation and the good effects of wise government expenditures, the standard must not be based solely on materialistic terms. Just as an individual may decide that his conception of a good life does not include a maximum attainable personal income, so the good life for the individuals who make up a society may involve a combination of public expenditures and taxation which actually impedes the development of a maximum national income. Even if the combination of taxation and public expenditures has a net repressive effect on total national production, the amenities derived from the government programs may add more to individual satisfaction than would the production which is foregone because it is, on balance, repressed by the level and nature of the tax system.

In summary, it is not true, as is sometimes presumed, that government activity is inherently and inevitably a drag on the economic system. Some of the government activities financed by taxation provide the very basis for the existence and operation of the private economic system, and others represent rational decisions in favor of forms of consumption which can be provided only through joint action. But it is also not true that all government activity is either indirectly productive or gives generally desired satisfactions available only by joint action; too much government expenditure is for the special benefit of limited groups who have been effective in investing their selfish interest with distorted sentimentality or masquerading it under a public purpose. It must further be remembered that the mere fact that a government program is good or that a government expenditure is for a worthy purpose does not mean that it should be undertaken. . . .

Choices must be made between public and private spending; these decisions determine what fraction of the country's total income must be taken in taxes to pay for the expenditures made through government agencies. Everyone will have his individual judgment as to what is wise and what is foolish in both private and public spending, but there seems to be no very good reason to suppose that a shift to more public spending with less private spending would necessarily result in a wiser allocation of the total.

It is currently fashionable among critics to deplore what they regard as public penury amid private profligacy. There is justification for this judgment when one notes the relative outlays on liquor and tobacco as compared with those on education, on cosmetics as compared with public health, or on ornamentation and gadgets on new automobiles as compared with highways on which to drive. But there is little reason to suppose that joint decisions through government would be much wiser than the sum of individual decisions made privately.

Those who advocate a shift to the public from the private spheres might be disappointed to find that the public outlays would, in fact, turn out to be on foolish things or for selfish groups, on balance no better than the sort of private outlays which they hoped to supplant. Also, the higher taxes required for additional government spending might make people reduce what the advocates of the change regarded as important individual family expenditures while frivolous and ostentatious private consumption is maintained. Over all, the generally repressive effects of higher total taxes would have impeded growth of the total national income, with little net gain in the wisdom with which it is spent. Though reform of our tax structure may reduce the bad effects of taxation and even permit a somewhat higher total tax burden than we now have without serious repressive effects, it by no means follows that larger government expenditures would produce a better society or even that the present level is justified, constituted as it is and is likely to continue to be of the same sort of

allocations, wise and foolish, extravagant and stingy, which we all make in our personal affairs.

A TAX SYSTEM should be as fair as possible, as simple (and certain) as possible, and impose minimum restraints on economic growth, at the same time fostering maximum economic stability. There would probably be general agreement that each of these three objectives is important in appraising a country's tax system. But though these concepts appear simple, there is much controversy on at least two of them. Opinions differ on matters of fairness and on the best way to raise revenue with minimum economic damage. Furthermore, agreements on each of the separate objectives would not assure agreement on the proper structure of a tax system because the objectives frequently conflict with one another and judgments differ as to the relative emphasis to be given to each. This section outlines the nature of the conflicts among objectives and then reviews the controversies concerning fairness. The next section considers the economic objectives of a tax system. The issues raised here in general form will be discussed more fully in the remainder of the book.

A simple tax system may not be regarded as fair, and provisions of the law intended to facilitate economic development may be criticized as being too complicated or as unfair. Virtually all the deductions and exemptions allowed in the individual income tax, for example, are intended to ease the burden of the tax and bring it more into line with the abstract and imprecise concept of ability to pay, and yet every deduction and exemption complicates the law. Tax forms and tax computations would be much simpler if the tax were based solely on income received during the year with no deductions for interest or for state and local taxes, medical expenses, charitable contributions, or casualty losses or even for personal exemptions with the complicated rules concerning the definition of a dependent.

Each deduction in computing taxable income is presumed to add, at least superficially, to the fairness of the income tax, and yet each one adds a line or a schedule to the tax form and requires record keeping and calculations to support it. Worse yet, the existence of any deduction is an invitation to create artificial transactions to come within the letter, though not the spirit, of a simple allowance. The simple allowance must then be hedged around with restrictions and qualifications to prevent abuse until it becomes so complicated that it is criticized even by those who benefit from it.

The deduction for charitable contributions, for example, is consistent with our tradition of private philanthropy and is probably necessary to maintain private charitable activity, but it is subject to serious abuse by people who attempt to claim deductions for fictitious values of property contributed to charities. Abuses in connection with claims for the original purchase price of discarded furniture or artificially high values for art objects as charitable contributions require tightening of the law at present. Interest deductions have been abused through unnatural if not altogether artificial claims for interest payments on so-called insurance policies which are designed almost entirely to provide taxpayers with current interest deductions against ordinary income, offset to some extent and in some instances by a much later tax on an eventual capital gain. An abuse of this sort is unfair to the vast majority of taxpayers who are not in a position to take advantage of the loophole—and one hopes might not be disposed to do so anyway. But if this loophole in the interest deduction is completely closed, the law will be made more complicated, and attempts to close it by statute have thus far been successfully obstructed by irrelevant but emotionally appealing talk of widows and orphans and small businessmen.

EXEMPTIONS of particular categories of income also lead to problems and abuse, even in the case of the basic personal exemption. The definition of a dependent had to be tightened, for example, because under a previous definition it was possible to claim as dependents the entire membership of a foreign orphanage, with a tax saving in excess of the actual cost of support. It was not only possible; it was done. Tax exemption of most scholarships and fellowships has been long recognized as a matter of equity because they are gifts and, as a matter of social policy, to ensure that the limited amount of funds for such purposes should go as far as possible. But the objective tests for such exemptions established in 1954 with the hope of clarifying and simplifying the law have been eagerly noted by some faculty groups as a basis for converting a regular salary payable during a sabbatical leave into a partly tax-exempt "fellowship," if university authorities would only alter the formal arrangements and methods of payment of sabbatical salaries. If this practice actually developed, the inequities arising from the abuse would certainly require complicating restrictions if not actual repeal of the basic exemption of fellowship grants.

In addition to the three principal objectives of fairness, simplicity and minimum restraint on economic growth, other considerations enter into policy decisions. An awareness of the nature and extent of tax burdens, for example, is desirable in a democracy, though it is repugnant to a dictatorship. This point is significant in the discussions of effects of tax withholdings on tax consciousness.

Tax policy may also be influenced by a multiplicity of social and political objectives. Differential rates and special depreciation allowances give preferences to particular products, activities or forms of investment. Small business, foreign investment and residence, and various aspects of farming are among the favored categories now in the law. A list of proposed differentials would be endless; it sometimes seems as though a first approach to all problems is a suggestion for a special tax allowance or rate.

Neutrality in taxation is assumed to be a desirable objective in this book. As a general proposition, taxation should not be used to influence consumption, personal activity or investment. The free play of prices, consumer choices and investment decisions will, it is believed, produce better results than can be secured from a directed economy. If one favors a controlled economy, taxation can be used as a powerful factor among the controls, but that is not the approach adopted here. ■

THE U. S. — NATION OF SAVERS?

by SIDNEY WEINTRAUB

► *With the proliferation of credit cards and other easy credit devices, there has been increasing concern that too much buying on "the never, never plan" may lead to an economic collapse.* SIDNEY WEINTRAUB, *former Chairman of the Economics Department of the University of Pennsylvania's Wharton School, and author of several books on income and price theories, concludes that at present there is no real cause for alarm. The statistics on consumer spending indicate that Americans, on the whole, are not living beyond their means.*

ONCE UPON A TIME a wallet contained money, photos and an identification card. Nowadays it is likely to hold also a Diners' Club card, hotel, rent-a-car and gasoline credit cards, as well as department store and bank charge plates. Whatever the exact contents of each private cache, they reflect the purchase and payment practices brought on by the evolution of modern transportation and communication.

About the only area where credit may be tighter than it was a generation back is in the field of retail food purchases; the old open-book accounts have practically disappeared with the advent of supermarkets and their cash-and-carry practices. But whether or not this show of resistance on the credit front will persist is an interesting conjecture. Some of the chains have announced their entry into discount house operations —and discount houses have already abandoned the cash policies which they once claimed permitted them to undersell department stores.

One can truly marvel at the glories of the United States where, by merely flashing a credit card, one can virtually acquire a home, furnish it, stock the freezer, seed the lawn and plant the shrubs. Scant wonder that the American consumer is envied the whole world over! But it is just this credit largesse that disturbs many people. They feel that we will have to face a day of reckoning when the entire consumer economy, infected with the easy credit virus, must collapse.

Their opinion clashes with that of the cult of salesmanship which urges us to amass goods now and weigh the cost later. Both attitudes are captured in the current British phrase describing installment terms as buying on the "never, never plan."

Clearly, it is possible to borrow too much. An individual who has overextended his credit must cut down his purchases even of essential items and alter his standard of living. Some of his belongings may be repossessed. He may have to face the stigma of bankruptcy, the loss of his credit rating, the mental anguish of trying to avoid bill collectors. In desperation he may seek temporary financial surcease through consolidated loan agreements which pile new interest charges on the family budget.

But if a person has a regular income large enough to cover installment payments without cutting into the money he needs for daily expenses, there can be nothing objectionable in the practice of buying "on time." After all, if a piano is going to be used and enjoyed over a period of 15 years, there is no reason why it should not be paid for over approximately the same period; the same principle is universally accepted in paying rent monthly or in making payments on a house.

THE ECONOMIC BASIS of the pay-as-you-go plan is indisputable. But also, of course, there are interest charges to be considered. However, even when purchases are made on a cash basis, an interest "charge" is involved as the sum of the purchase might have been collecting interest if it had not been spent.

Hence individuals, like corporations, will go into debt, and often for the same reason—to achieve efficiency of operations. Whatever our personal view of consumer loan financing, we can be sure that credit will continue to be extended and consumer borrowing will remain part of our everyday life. In a society that prizes individual freedom there must be a minimum of outside interference with the consumer—with the quantity and variety of goods he buys, with the length of time he uses such goods, and with the mode of payment he has agreed upon with the seller. While interest charges on borrowings can be a budget burden, they are often less onerous to borrowers than the sacrifice entailed in deferring a purchase.

If an individual never bought an item until he had first accumulated enough money to buy it outright, he would often not have the item on hand when he needed it most. Washers and driers, for example, are most useful to couples with babies and growing children. But a young couple is likely to have few resources available for the purchase of such expensive items. Their children might be grown and their need for a washing machine less pressing by the time they could afford to pay the complete purchase price. In this way they could go through life deferring purchases until they were no longer necessary. But their life would be needlessly hard and their money left to their estate. Thus, forethought is required to plan a pattern

of income allocation, despite limited knowledge of future earnings, tastes and available goods.

But if the individual is given the freedom to buy and borrow, how can we be certain that he does not become overcommitted and thereby involve *others* in loss and personal injury?

Character still stands foremost on the list of qualities necessary to ensure the honoring of the credit contract. Granted this, *the main external circumstance required for the prevention of widespread loan default is the continuance of high and stable employment.* In other words, prosperous conditions must be maintained. When individuals have regular employment, and when their earnings are steadily increasing, they can usually meet reasonable credit obligations. And since real incomes in the U.S. have grown in recent years as a result of productivity improvements, the consumer indebtedness incurred in the past has actually become less onerous.

BUT, on the whole, do people in the United States owe too much money? The first significant fact is that, since the Great Depression hit bottom in 1933, personal savings have been a positive part of personal income. Between 1956 and 1960 the aggregate surplus of savings out of income has ranged from $23 billion to $26 billion per annum. For 1961 the savings figure may reach as high as $28 billion, according to first quarter estimates. Over-all, personal savings have comprised about seven per cent of disposable incomes in recent years.

While on balance the statistics reveal that consumers are *net savers,* several interesting facts are concealed in the aggregate figures. These facts, while not necessarily alarming, are somewhat disquieting. On the basis of (a) a Federal Reserve report on consumer finances, (b) a Department of Commerce study on Income Distribution, and (c) a study of personal savings made by Professors Friend and Schor of the University of Pennsylvania, the following inferences on consumer indebtedness and consumer savings can be made.

• Families (or spending units) who earn $3,000 or less after taxes have *no* savings; instead, as we might expect, they are actually spending more than they are currently earning.

While more than 20 per cent of all spending units are probably still to be found in this category, we cannot take this fact as evidence that people are overspending. For this group is composed largely of students, the temporarily unemployed, and retired citizens who are living on pensions and past savings. It is probable that on a per capita basis this income class makes least use of available credit facilities. Although precise figures are difficult to establish, it is estimated that *about half of this income group has no personal debt whatsoever,* and that only about four per cent owe more than $1,000.

• Spending units with incomes ranging from $3,000 to $6,000 have some savings—on balance from about 2.5 per cent of income at the lower end of the scale to about 6.5 per cent at the upper end.

In this class, which includes perhaps one-third of the spending units in the economy, are concentrated many of the people who buy the products of our mass production industries. Consequently, a good portion of consumer installment credit for durable goods is presumably extended to members of this income group. Nevertheless, the excess spending on the part of some members of this group is cancelled out in the over-all picture by the savings of others. Most wage earners are to be found in this group. It is estimated that about one-third of this income class was free of personal debt in 1959 while about one-sixth had debts amounting to more than $1,000.

• Spending units with earnings of $6,000 and over show savings amounting to about 10 per cent in the lower ranges to over 30 per cent among those who earn more than $12,000. While it is not unexpected that the largest share of personal savings are concentrated here, the estimate that 80 per cent of total savings are generated in this class may seem astonishing to those who examine the statistics for the first time.

Undoubtedly it is in this last income group that we find the great proliferation of credit cards; it is for this group that credit doors are most quickly opened. Fortunately, despite sensational episodes reported from time to time in the newspapers, the total credit record of this group is very good. Perhaps a third of the spending units in this most fortunate of the economic classes are entirely free from personal debt; about another third have debts in excess of $1,000. (Personal debt, as the term is used here, includes installment finance, but omits charge accounts, mortgages and any business debt of individual business proprietors.) About half of those with incomes in excess of $10,000—about one-seventh of the entire upper-income group—are wholly free of personal debt, while about 30 per cent have more than $1,000 of personal debt listed against them.

What are we to make of all this? A reasonable conclusion is that if credit overextension becomes a problem in the future, the greatest distress is likely to occur among those who earn between $3,000 and, say, $8,000. These are the people who buy so many of the items turned out in our mass production economy. Their savings are, on balance, nominal but too many installment facilities made too easily available could bring ruin to many individuals in this group. However, the data indi-

cate that prudence is exercised by most of this income group, for only about 17 per cent have obligations in excess of $1,000.

When we consider the simple magnitude of consumer credit outstanding, the situation may appear to be somewhat more alarming. At the close of 1960 about $56 billion in consumer credit was outstanding. At the end of June, this year, the total amounted to $54.8 billion. If we consider that in December, 1954 the total was $32.5 billion, we can see that outstanding consumer credit has grown substantially. The only annual decline was registered in the recession year 1957.

Of the approximately $55 billion in consumer credit currently outstanding, installment credit comprises $42.4 billion; of this total, automobile financing accounts for some $17.4 billion, or about 30 per cent of the total $55 billion credit figure. Personal loans amount to some $11.5 billion, while charge accounts total $4.3 billion.

In comparative terms, consumer credit thus amounts to about 13 per cent of the national income and to about 15 per cent of disposable personal income. When automobile financing is eliminated, the figures run to about eight per cent of the national income or to 10 per cent of disposable personal income. These percentage figures seem less formidable than the simple aggregates.

Installment credit extensions usually seem to parallel the course of the business cycle, rising on the upswing and slowing on the downcurve. During recessions, as payments are made on larger outstanding bills, new obligations do not fully replace the old and there is a net decrease in amounts outstanding. The first half of 1961, for example, has seen some debt reduction to the tune of about $250 million. The current business upswing has so far not resulted in piling new consumer debt on old. Undoubtedly this ratio of credit extensions to repayment will turn about in the not too distant future. For the present, however, misgivings about events in the consumer credit field have become quiet and undoubtedly the application of any remedial recommendations will be deferred a little longer.

Current phenomena also reflect the failure of the consumer durables sector of the economy to share in the economic rebound. But, of course, the present softness in these markets may be due in part to the excess indebtedness incurred earlier which is still being paid off.

There are those who argue that consumer borrowing tends to raise interest rates and to reduce the volume of funds available for investment purposes by business firms. For this reason they feel consumer credit should be restricted. But if this argument is valid, would it not be just as valid for consumers to protest borrowing by business on the ground that it raises the cost of funds to them?

All demands, from whatever source, raise interest rates. But this does not mean that one group should be excluded from the market place merely for the benefit of other groups. If this were done, what meaning could then be attached to the term "free economy"? In fact, interest rates have been low during the recession largely because of Federal Reserve policy. And if interest rates rise during the present recovery, which is likely, this too will no doubt occur primarily because of Federal Reserve policy. The distribution of loan totals among consumer and business borrowers actually has very little to do with the level of interest rates.

In general, a study of the facts scarcely supports the conclusion that consumers are "overspending" or that we need to take action to restrain consumer credit. For, on balance, people in the U.S. are saving, despite the fact that some of them are probably living beyond their means. Savings and loan associations are growing phenomenally and giving glowing reports of their burgeoning resources. Apparently many of our citizens, when working on well-paying jobs, are more prone to save than to spend too much. For the most part, consumer purchases are contingent, not upon credit availability, but on income. ■

Is government policy at fault?

Dilemma in the MINING INDUSTRY

by FRANK A. TINKER

► *The domestic mining industry is facing a crisis. A combination of high production costs and foreign competition has resulted in abandoned mines, unemployment and depressed areas. Domestic producers feel that their tax dollars are being used to subsidize foreign competitors under the guise of assistance to underdeveloped areas.* Frank A. Tinker, *free-lance writer and former foreign service officer, feels the only answer is a long-range program similar to the Sugar Act dividing the U.S. market among various foreign and domestic producers.*

Important segments of the U.S. mining industry are on the verge of disappearing. The reason is simple: imported metals and ores are cheaper. Around this fact swirls a maelstrom of arguments and counterarguments whose main effect is to create confusion.

The coal mines in the East and the nonferrous mines in the Midwest and Far West have been the hardest hit. Strangely enough, although there has been general sympathy for the state of the depressed coal areas, the situation in the Western states is usually thought of as one where a "special interest" group is intent only on feeding at the federal

trough. But food stamps are being issued in mining districts of both West Virginia and Montana—a fact that bespeaks real tragedy.

In several states mining has practically ceased. For instance, in Utah there were scores of lead and zinc mines a decade ago valued at $9.5 million. Now there are only four of appreciable size operating—some of these on a marginal basis; in total they are worth about $2.5 million. In Oklahoma, Missouri and Kansas, some of the oldest and most efficient lead and zinc mines in the country have recently closed.

Cobalt miners in Idaho are in the same predicament; new ghost towns may be created there by imports from the Congo. Again, U.S. producers of fluorospar (a mineral essential in the production of rockets) mined 320,000 tons last year, while 390,000 tons were purchased abroad. The domestic mine owners say they will have to shut their mines completely unless some restrictions are placed on Mexican imports.

So it goes from state to state. As a result only 686,000 persons are classified as miners by the U.S. Department of Labor today, whereas the number was 1,120,000 a decade ago. Half of these 686,000 "miners" are actually working on petroleum extraction; this means that the situation in what is ordinarily thought of as mining is even more disturbing than the figures indicate.

To some people this trend seems highly desirable for several reasons. They may believe in extensive foreign aid and/or that domestic mining should have no further federal protection or assistance. In addition, they will point to the huge $8 billion stockpile of metals and other materials which many observers feel is larger than the nation could possibly use—even in a long war. This stockpile, which is stored in more than 300 depots throughout the country, was authorized by a law passed in 1946. At that time, military leaders urged that the nation have a five-year backlog of metals in anticipation of a national emergency which might cut off access to normal sources of supply.

Naturally, this program stimulated both domestic and foreign producers to boost their output. Eventually the stockpiling program was criticized as a subsidy to domestic mining interests—in many cases by persons urging subsidies for other sectors of the economy.

When domestic production of uranium was urgent, the Office of Civil and Defense Mobilization (OCDM) turned to the nation's small miners to find and provide the ore needed. These enterprising prospectors and diggers were so successful that a "stretch out" of the buying program was instituted recently.

As a result, several large government mills were closed and new communities were left stranded. The U.S., once a have-not nation in uranium, vaulted to third place in the list of countries with proven reserves.

In other metals much the same story has been repeated. During the Korean war copper production was stimulated by the government. At that time it also seemed reasonable to barter our farm surplus for foreign metals. But the effect of doing so was to increase overseas production too rapidly. In effect, the U.S. was subsidizing mines overseas—and the voices which had earlier protested against subsidies at home were now stilled. The recent suggestion by the Kennedy Administration to barter some of our food surpluses for more metals was understandably received with hoots and hollers from domestic producers.

The net result of both purchase and barter of foreign metals was the same—further accumulation of surpluses. In 1959 our lead stocks reached a high of 368,873 tons, despite the fact that during the previous year domestic production was the lowest since 1899. By contrast, at the same time, world stocks were only 92,397 tons. Today, smelters have on hand a full year's production—some $80 million worth.

Yet the present Administration, despite the industry's objections and the apparent lessons of history, has proceeded with adding to this stockpile. In recent transactions with Australia and Canada, 100,000 additional tons of lead were acquired in exchange for surplus agricultural products. The Administration asked these countries to curtail their lead production, but it will take more than promises to solve the problems.

As the volume of imports increased, various measures were urged to protect the output of mines in the U.S. and to prevent them, in some cases, from closing completely. In 1954 the Tariff Commission ruled that the nation's mines had suffered "serious damage" from foreign competition. An import tax of 1.7 cents a pound placed on copper, however, probably caused few headaches in the headquarters of the large domestic producers—Kennecott, Anaconda and Phelps-Dodge. All have large holdings in South and Central America. As international companies they are not happy at being thought of as part of a "special interest" group that wants to restrict the entry of ores from abroad.

In 1958 another attempt was made to protect domestic producers from foreign competition. Import quotas were placed on lead and zinc. The quotas, however, were set at a fairly liberal 80 per cent of the 1953-57 average. Domestic prices immediately rose by one-fifth, from 10 cents to 12 cents a pound. Within a year, however, the Federal Reserve ruefully acknowledged that the importers had successfully evaded the quotas by shipping in semifinished lead in the form of sheets, pipe and "cannonballs."

The domestic metals industry itself is far from united with regard to the problem's solution. For example, while Missouri miners were protesting against lead and zinc imports, the American Smelting and Refining Company's large Midwest smelter

was closing because, according to management, the import quotas were too low. And take a look at another aspect of the situation. Although it is to these smelters' advantage to be able to purchase imported ores cheaply, it is equally to their disadvantage to have cheap *refined* metals enter without restriction. As long as tariffs remain in force on refined metals, it is only a half-truth to claim that the importation of foreign *ores* enables us to produce cheaper metal products. The argument carried to its logical conclusion would mean the removal of *all* import restrictions.

Some critics of the domestic mining interests are sure that it is only proper to close all uneconomic U.S. mines. Such critics argue that if their facilities are uneconomic, their good ores exhausted and their costs exorbitantly high, the government should not be called upon to support them; a moribund industry, they say, would be better off dead. Surely, these critics say, under normal circumstances, many U.S. mines would have closed anyway; only the stockpiling program saved them. True, but many foreign mines also would have ceased to operate.

Even more significantly, some of the most important of these foreign operations would have collapsed without U.S. funds to refinance them and U.S. technical aid to modernize them. The domestic mine owner, faced with competition from foreign sources, complains that his tax dollars have revitalized the competition, while he must provide the same modernization from profits or borrowed capital.

As for efficiency of management, there is certainly much evidence that domestic mines are better run than most of those overseas. And the one factor where cost varies widely between the U.S. and its competitors in mining is labor. In the U.S. this labor is so skilled and the mines operated so efficiently that they still fall only slightly behind foreign competitors. This is so even though many competitors are working higher grade ores and paying wages lower than the taxes on an American miner's paycheck. Domestic miners have received the greatest wage increase of all nonmanufacturing industries since 1947; average weekly pay rose from $51.63 to $113.05, an increase of more than 100 per cent.

Nevertheless, the argument that high-cost U.S. mines should close is heard in many influential circles. The Mexican Ambassador in Washington, Señor Antonio Carillo-Flores, recently went further and suggested that all "developed" nations resign from the production of raw materials obtainable in the less advanced areas of the world. In the U.S. this suggestion is countered by those who continually assert that national security and welfare demand a vigorous and progressive mining industry. These people are not lacking in good will toward our poorer neighbors, but they feel that the position of the U.S. today would be intolerable if its entire supply of cobalt came from Cuba or the Congo, and its canning industry were completely dependent upon tin from Bolivia.

They remember, for example, that in 1952, before the Bolivian government nationalized the country's tin mines, Bolivia produced 10,000 tons of metal annually. Now production has fallen to one-half that amount. Featherbedding became so widespread that economic operation became impossible. At the present time, however, Bolivia is asking for $6.5 million to modernize and repair the mines—mines which were in good condition when they were nationalized less than a decade ago.

In Chile one-fourth of the government's revenue and two-thirds of its foreign exchange are derived from the export of copper. Overproduction caused the price of the metal to sag from 44 cents a pound to 25 cents in the three years following 1955. Under this blow, the Chilean peso collapsed. Advisers from the U.S. arrived to help Chile's major industry get back on its feet, and the International Monetary Fund advanced the funds to stabilize the currency.

The moral needs no belaboring: our aid to many countries—in mining as well as in other matters—may have to be continuous to be effective at all. Until such aid produces a reasonable stability, however, to depend on any given country for a strategic mineral seems illogical, even to many persons with no direct financial interest in domestic mining.

Perhaps an even better argument is the need for continued research in mining and the use of metals. As our known deposits of ore decline in grade, either better methods for utilization or a shift to other materials is necessary. This is the only means by which the domestic industry can offset high costs, and it is the traditional approach in Western mining areas to the whole question of foreign competition.

Advances in techniques based on research have become commonplace recently, and may help cure the domestic mines' financial woes. Here are some examples:

- A new combined cyanide-flotation process that may soon make lead profitable here even at present prices.
- A chemical process for concentrating beryllium ores that may well make domestic production of this "new" material economically feasible. Incidentally, in the Topaz Mountains of Utah there is one deposit that would supply the country for years.
- The advent of pinelines carrying coal in slurry form. This development may mean that coal will be used in many new areas and indus-

tries where heretofore it has been too expensive to transport.

• The use of taconite in place of iron ore—an important development which is spreading. Huge installations in Minnesota and Wyoming are now being made ready for large-scale production of this concentrate of low-grade iron ore. Deposits of taconite in the North Central and Western states are huge and *could* be developed.

In the face of this evidence of its progressive outlook, the mining industry feels that the government should have more sympathy for its present predicament. Its managers feel that the country's political leaders do not appreciate the fact that their high-cost, high-risk investment takes many years to pay off. Miners feel that the welfare of Mexican labor is more important to the Administration than their own. Both are aware of the battle in Washington between the State and Interior Departments, one fighting for the international influence of the United States by means of a "liberal" foreign economic policy, the other supporting domestic industry, but knowing that its power is limited.

As a result, there has been no major new legislation aimed at improving the situation of the miners during the past decade. And during those 10 years employment in U.S. mining has halved.

Is there a solution acceptable to all concerned? Can any legislation dissolve the surplus which hangs over the entire mining industry? Lawmakers have hesitated, perhaps forgivably, to add to the near catastrophe that has been the main effect of their previous intervention in the market. What action there has been was by executive order, while most agencies of the government concerned in one way or another with the industry's problems are content to await the increase in consumption which they believe is inevitable as population and incomes rise over the years.

Within the desperate mining community, however, several proposals have been made—some merely stopgap measures, others long range. The former are tariff bills aimed at giving the hardest-pressed mines a reprieve. An emergency committee on the lead-zinc imports pushed legislation but Congress preferred to accede to State Department objections and cancelled all references to tariffs.

After the House had passed the bill including tariffs, the Senate added its own mild subsidy provision. As it turned out, this subsidy was the only part of the bill that finally made its way through the session. It was fairly meaningless to the industry as a whole, however, since the bill is worded so that the only miners to receive aid will be those in the Midwest. Further, the money to finance this subsidy must be voted by each session of Congress. So it still remains to be seen whether or not the subsidy will be effective. At any rate, the bill, such as it is, has been signed by President Kennedy.

As for the more important over-

all plans, toward which many of the segments of the metals industry may be tending, they are best exemplified by a proposed fluorospar bill which failed to get a hearing in the last Congress. The majority of our supply of this mineral is now coming from Mexico, although equally good deposits are available here. Some restriction on these imports is needed if domestic production of fluorospar is to survive. On the other hand, the Mexican mines are almost wholly dependent on the U.S. market. Therefore, Mexican-U.S. cooperation on planning the development of fluorospar is an essential part of any balanced North American economic policy aimed at promoting the health of the mines and the defense of the hemisphere.

Knowing this, mining leaders have suggested in the flourospar bill that U.S. purchases of this mineral be made abroad in much the same way as our sugar now is procured under the generally successful Sugar Act—through the use of quotas for various countries. Traditional producers would be given quotas, domestic mines would be assured a market and everyone might be content, if not wildly happy.

Throughout 1961, however, the fluorospar bill languished in committee, and there is general despondency among its supporters over its chances of being enacted in the near future. The main reason, they claim, is the traditional hostility among legislators toward any proposal put forward by "special interest" groups.

An unbiased observer might conclude that the proposals deserve something better—at least a longer look. After all, mining interests *are*, in some respects, also national interests.

Some segments of the mining industry have expanded both their operations and outlook to the point where they have gone well beyond their previous opposition to the "internationalization" of the metals market. From these segments comes the suggestion for a conference among all major contributors to the U.S. minerals market.

What many American miners want today is not the repair of high, out-of-date tariff fences. Rather, they plead with a reluctant government for a long-range plan on which they can base their operations.

It is not an easy plea to face, but it is even more difficult not to face it as chronic unemployment rises in the country. Sen. Frank Church (D.-Idaho), a close friend of the Administration, has said that there will be a new long-range minerals policy announced before 1962.

Some such scheme, definite and durable, will have to be adopted soon to clarify the situation. In mining parlance, "drifting" means to follow a vein outward from a main shaft. But for a government to drift now, in the more generally accepted meaning of the word, would be to seek disaster rather than profitable ore. ■

The Ability to Pay

by LEWIS H. KIMMEL

The Ideologies of Taxation. Louis Eisenstein. 263 pp. New York: The Ronald Press Co. $5.00.

THE IDEOLOGIES OF TAXATION is a lucid and slightly sardonic account of the shortcomings of the federal income tax and the tax-making process. In Louis Eisenstein's usage, ideologies embrace "the modes of thought to which groups and interests resort in order to obtain tax laws to their liking." Attention is focused mainly on three ideologies: (1) ability to pay; (2) "barriers and deterrents"; and (3) equity.

The ability-to-pay rationale has been sharply criticized in recent years. Economists and tax specialists have come to realize that the line of demarcation between ability to pay as a basis for apportioning the tax burden and the redistribution of income that results from progressive taxation has always been hazy. A principal contribution of this volume is that it shows how far the federal income tax has departed from any reasonable concept of ability. The additional exemptions for persons over 65 and the blind regardless of economic circumstances, and the lower level of personal exemptions despite the higher price level, are merely a few of the elements of the tax structure that make it difficult to reconcile the present system with the ability doctrine. Examination of these and other cases of special treatment leads to the conclusion that the "troubled ideologists" of the ability-to-pay philosophy "are merely applying the ancient maxim that the end justifies the means."

The ideology of barriers and deterrents, the author holds, is substantially without merit. High tax rates have not prevented the vigorous functioning of the economy in the years since World War II, and the worst depression of modern times occurred at the close of a decade in which a tax policy that stressed barriers and deterrents held sway. In developing the argument, the "melancholy and ominous" report of the Special Tax Study (Magill) Committee appointed in 1947 to advise the Committee on Ways and Means and the so-called Mellon tax philosophy of the 1920s are singled out as major targets. Effective use is made of the excellent Harvard studies of the early 1950s by Keith Butters, Challis Hall and Thomas Sanders, among others.

TO INFORMED OBSERVERS it has long been apparent that the adverse effects of high tax rates are frequently exaggerated. Four decades ago Arthur Stone Dewing pointed out that the incentives that motivate business executives are by no means exclusively—or even primarily—financial in nature. Later empirical investigations confirm the view that modern business executives bear little resemblance to the economic man of classical theory. Mainly for this reason, as Eisenstein observes, the arguments advanced in support of stock options and other tax preferences for executives are unconvincing. At lower levels of income—for wage earners generally—high taxes seem to work both ways. On balance, any deterring effects are probably offset by additional effort put forth to maintain living standards.

At the same time, a question may be raised whether there is any merit to a tax philosophy that would completely ignore the realities faced by the business community and investors. Assuming a constant price level, it can be argued that on equity grounds capital gains should not be accorded special treatment. But what about a capital gain of 80 per cent achieved during a period when the price level has doubled? However convincing the argument that equity requires the taxation of capital gains at regular rates, the facts of life may support a compromise solution. High corporate tax rates have influenced the capital structure; and depletion allowances and other special provisions have affected the direction of investment. Depreciation allowances (they are not considered in this book) are a major influence in decisions concerning plant expansion. Taking into account only the investment process, the "economics of taxation" is clearly not a meaningless term.

AFTER eight chapters that include numerous pungent criticisms and comments, the informed reader will approach "The Pursuit of the Public Interest" (Chapter IX) with enthusiasm. Presumably the author will now show how the tax structure can be welded into an instrument that will be in harmony with the public welfare. But we are informed that to "offer the public interest as a solution is to offer no solution at all"; and the "public interest is an empty vessel into which everyone pours his private preferences."

Surely the concept of the public interest in taxation is not entirely devoid of meaning. If this were true, the labors of many prominent Americans—including Cordell Hull and E. R. A. Seligman—have been largely in vain. Many contemporary professors of public finance and economics have a well-defined philosophy of taxation which they believe is in the public interest. Their carefully reasoned views cannot be dismissed in cavalier fashion as mere "private preferences."

The solution to the problem of pressures and special dispensations,

► LEWIS H. KIMMEL, *Senior Staff Member of The Brookings Institution, is a specialist in problems of taxation.*

one finds, has merely been deferred to a final brief chapter. The "answer is to elect Congressmen who do not have to yield." How are they to be obtained? This, Eisenstein concludes, "is indeed a difficult question, but on such questions I can no longer speak as an expert." The "conclusion" is entirely logical. One who holds that the concept of the public interest in taxation is invalid and inadmissible should not be expected to offer challenging suggestions, let alone advance a program of tax reform.

The problem of pressures and their distorting effects on the tax structure, with which the author is largely concerned, has been ably considered by T. S. Adams, Roy Blough, William L. Cary and others. In this book the elements of the problem are presented in more detail but less objectively than in earlier writings. *The Ideologies of Taxation* is well written and interesting. A hypercritical and negative tone detracts from its effectiveness.

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The Farmer's Dilemma. Stanley Andrews. 184 pp. Washington, D. C.: Public Affairs Press. $4.50.

• One-third fewer Americans produced 55 per cent more farm products in 1958 than in 1938. This simple fact sums up the cumulative effects of advancing technology on one of the oldest vocations known to man.

The background and effects of this amazing revolution are explained in detail by Andrews, who has had wide experience working with government agricultural programs for over 30 years.

It is, of course, a well-known fact that the tremendous increase in farm productivity has not raised the income of farmers. In fact, the average farmer has been receiving an ever-smaller proportion of the benefits of our affluent society. Part of the reason is that, while output per man-hour has increased about 50 per cent since 1948, output per unit of farm machinery has *declined* by 40 per cent. The author points out that—so long as the economic benefits of farm efficiency are absorbed in high market costs, increased costs of equipment and services, and high interest rates—increased mechanization is *not* going to increase net farm income.

Andrews feels that it is time to stop the present drift in farm policy—that instead of stop-gap measures we need a comprehensive, long-range national agricultural program. In establishing this program we need first to decide whether we want to promote large, estate-type farms or smaller family operated enterprises. In this connection, the author points out that medium-sized farms may actually be more efficient because they get a greater return on their labor.

Whatever method is chosen, certain economic and political realities make it necessary to consider at least three basic premises under which our farm policy should operate in the decade ahead. They are: (1) society and not the political power of farmers will shape the agricultural policy of the future; (2) American agriculture must be considered part of the world problem; (3) we must maintain not only the productive strength of our farms, but also provide opportunities for those individuals who choose farming as their way of life.

In his concluding chapter, Andrews presents the kind of program he feels should grow out of these premises. Though not everyone will agree with the author's conclusions, and some may wish he had spelled out his program in greater detail, *The Farmer's Dilemma* represents a common-sense study of an area of our economic life where common sense is certainly needed.

* * *

The Achieving Society. David C. McClelland. 512 pp. Princeton, N. J.: D. Van Nostrand Co., Inc. $7.95.

• The question of economic growth has long fascinated economists. Ever since Adam Smith they have been perpetually asking such questions as: What motivates an achieving society? Why do some societies achieve fantastic growth rates while others in a similar environment stagnate? What causes the decline of a great empire?

Traditionally, economists have attempted to answer these questions in terms of technological change, population growth, division of labor and capital investment. But economic theorists themselves have frequently speculated that the sources of change may lie *outside* the economic system. *The Achieving Society* represents the first attempt by a psychologist primarily interested in human motivations to shed some light on this problem.

Prof. McClelland bases his study on the hypothesis that one human motivation—the need for achievement—may play an important role in determining a society's economic development. He draws extensive evidence from history and several contemporary nations to support his hypothesis; he also applies against it theories explaining the rise and fall of civilizations as advanced by Toynbee, Spengler, Marx, Weber and others.

The author goes on to explain how a strong need for achievement promotes successful entrepreneurship. His findings on this subject provide a basis for suggestions on how to accelerate economic growth in underdeveloped countries by increasing the human motivation needed for success. The presentation throughout emphasizes the application of the methods of the behavioral sciences to traditional problems in history and economics.

Though the book is vast in scope and deals with a great many technical problems, it is unfailingly interesting and well written. Economists and historians may question the validity of the study on the basis of the author's self-confessed limitations as a student of history and economics. But whatever may be the final evaluation of the historical significance of this book, there can be do doubt that it represents a stimulating and original contribution to the study of economic growth.

Also of interest

Federal Aid to Education. Edited by Ronald Steel. 207 pp. New York: The H. W. Wilson Co. $2.50.

Pan America in Crisis. William Manger. 105 pp. Washington, D. C.: Public Affairs Press. $3.25.

Political Influence. Edward C. Banfield. 354 pp. Glencoe, Ill.: The Free Press. $6.00.

Productivity Trends in the United States. John W. Kendrick. 630 pp. Princeton, N. J.: Princeton University Press. $12.50.

The Emerging Nations: their growth and United States policy. Edited by Max F. Millikan and Donald L. M. Blackmer. 171 pp. Boston, Mass.: Little, Brown & Co. $4.50.

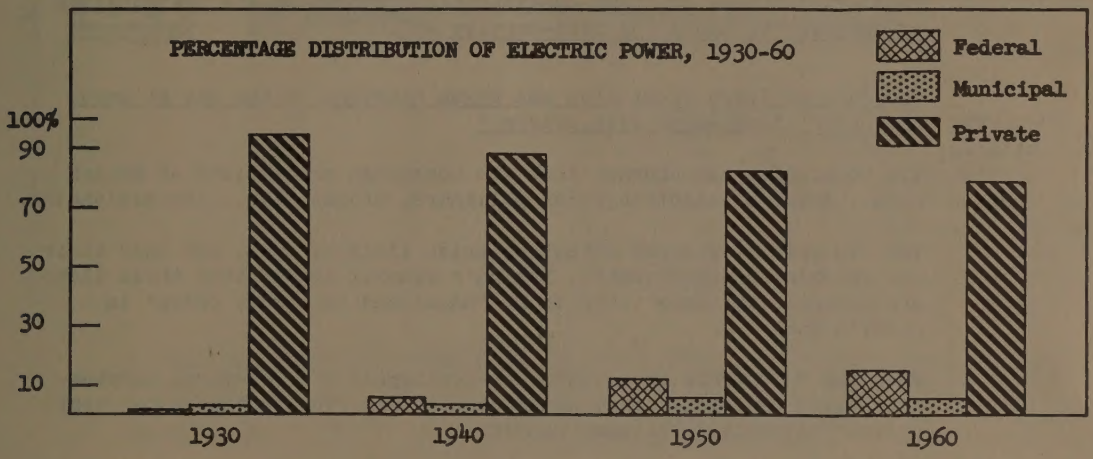
The Postwar Residential Mortgage Market. Saul B. Klaman. 301 pp. Princeton, N. J.: Princeton University Press. $7.50.

The Problem of Rising Prices. William Fellner, Milton Gilbert, Bent Hansen, Richard Kahn, Friedrich Lutz and Pieter de Wolff. 489 pp. Washington, D. C.: The Organisation for European Economic Co-operation. $3.75.

The Role of Debt in the Economy. Helen J. Cooke. 115 pp. Washington, D. C.: Public Affairs Press. $3.25.

THE DOMESTIC ECONOMY—The question of public vs. private power has been—and will continue to be—a hotly debated political issue. How significantly has the public sector encroached on the private since the issue came into national prominence with the establishment of the Tennessee Valley Authority in 1933?

In 1930 publicly owned power accounted for only 5.5% of the kilowatt-hours of electric power generated in the U.S. (4% municipal and 1.5% federal; see graph below). The remaining 94.5% was in private hands.



By 1940 the public share was up to 11.6%. Although the municipal portion remained about the same, the federal share had risen to 6.1%. The private sector was down to 88.4%. In 1950 the public sector reached 18.9%. Again the increase was due to the increased federal share (12.2%) as the municipal portion remained about the same.

Last year public power accounted for 23.2% of the kilowatt-hours generated. The lion's share (almost 15%) was federally owned. The private sector was down to 76.8%.

While the public share of the power industry more than quadrupled over the last 30 years, the municipal share has remained relatively constant. Since the state-owned portion is still negligible, the basic conflict is between federal and private power.

There are, among others, two basic questions in the controversy. Is public power unfairly competing with privately owned companies in certain areas? And, conversely, hasn't public power undertaken tasks which the private sector was either unable or unwilling to get into?

Despite the emotion which is generated on both sides, these questions could probably be answered in the affirmative. While there is no foreseeable solution to the dispute, the federal government could certainly clarify matters by stating what its over-all power policy is. Does the government enter the picture only when there is a demonstrable need for power which the private companies have failed to provide? Or is it a question of which localities exert the strongest political pressure on the Administration?

"agency shop" ruled legal

ECONOMIC NEWS NOTES—The National Labor Relations Board has held that the "agency shop" is legal under the Taft-Hartley Act.

The agency shop, a device for escaping state right-to-work laws, makes compulsory the payment of union dues by all workers in a given plant.

The NLRB ruled that General Motors must bargain with the United Auto Workers regarding the compulsory payment of union dues by its employees in Indiana—which has a right-to-work law.

The Board's decision has far-reaching implications for companies doing business in the more than a score of states with right-to-work laws. It is bound to bring considerable pressure on the next session of Congress to amend the Taft-Hartley Act.

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FTC attacks list prices

The Federal Trade Commission has begun hearings on the use of manufacturers' "suggested list prices."

The Commission has charged that the suggested price lists of Regina Corp., maker of electric floor polishers, brooms, etc., are misleading.

The FTC said it was not attacking price lists as such, but only their use for misleading purposes. Regina's counsel argued that these lists are a necessity since there is no "usual and customary price" in today's market.

When the fair trade price structure collapsed after several unfavorable court decisions, many manufacturers resorted to "suggested list prices" to achieve the same result.

If the FTC casts doubt on the legality of list prices, manufacturers and small retailers are bound to appeal to Congress for remedial legislation.

* * *

increase in steel prices?

A drop in the price of primary aluminum imported from Canada has led to price cutting in the aluminum industry.

Since steel must compete with aluminum in the building trades and in other specialized fields, the steel industry might be forced to hold the price line while its wage bill goes up.

The ultimate decision on a steel price rise will probably depend more upon such competitive factors than upon Administration pressures to forestall what it considers another inflationary price increase.

* * *

aid for textile industry

President Kennedy has announced that the government will permit textile concerns to claim a faster tax write-off on certain types of cloth-making machinery.

This will enable U.S. manufacturers to install the most up-to-date equipment to meet competition from low-wage areas such as Japan.

It is also designed to blunt some of the pressure being exerted by textile producing areas for higher tariffs on Japanese imports. If the Japanese are shut out of the U.S. market they may be forced to turn to Communist China as an outlet for their manufactures.